

No. 12639

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United States  
Court of Appeals  
for the Ninth Circuit.

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COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

vs.

BIRCH RANCH AND OIL COMPANY,  
Respondent.

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Transcript of Record

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Petition to Review a Decision of the Tax Court  
of the United States

**FILED**

OCT 30 1950

**PAUL P. O'BRIEN,**  
CLERK



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Court of Appeals  
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## INDEX

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	PAGE
Amended Petition .....	33
Answer .....	53
Answer to Petitioner's Supplement and Amend- ment to Petition .....	131
Answer to Second Supplement and Amendment to Petition .....	148
Appearances .....	1
Certificate of Clerk .....	428
Decision .....	411
Docket Entries .....	1
Findings of Fact and Opinion .....	385
Findings of Fact .....	387
Opinion .....	397
Memorandum Findings of Fact and Opinion...	100
Motion .....	425
Motion to Reopen Case.....	115
Notice of Filing Petition for Review .....	423, 424
Notice of Record on Review .....	427
Order .....	116

	INDEX	PAGE
Order Enlarging Time . . . . .		426
Petition . . . . .		5
Exhibit A—Deficiency Notice and State- ment . . . . .		25
Petition for Review and Statement of Points ..		412
Petitioner's Designation of Contents of Printed Record on Review . . . . .		439
Proceedings . . . . .	56, 117, 150, 271	
Opening Statement on Behalf of the Peti- tioner . . . . .		57, 152
Opening Statement on Behalf of the Re- spondent . . . . .		70, 167
Respondent's Computation for Entry of De- cision . . . . .		408
Stipulation to Correct Transcript . . . . .		383
Stipulation of Facts . . . . .		134
Stipulation and Order . . . . .		431
Supplement and Amendment to Petition . . . . .		127
Witnesses, Petitioner's:		
Landrum, Robert R.		
—direct . . . . .		211
—cross . . . . .		221
—redirect . . . . .		258, 261
—recross . . . . .		259, 264

INDEX

PAGE

Witnesses, Petitioner's—(Continued) :

Birch, A. Otis

—direct ..... 272

—cross ..... 299, 343

—redirect ..... 349

Witness, Respondent's:

Webb, Madeleine

—direct ..... 340



## Appearances

For Petitioner:

GEORGE ACRET, ESQ.

For Respondent:

EARL C. CROUTER, ESQ.

## DOCKET ENTRIES

1945

July 13—Petition received and filed. Taxpayer notified. Fee paid.

July 13—Copy of petition served on General Counsel.

July 25—Amended petition filed by taxpayer. Copy served 7/25/45.

July 30—Entry of appearance of George Acret as counsel filed.

Aug. 29—Answer filed by General Counsel.

Aug. 29—Request for hearing in Los Angeles, Calif., filed by General Counsel.

Aug. 31—Notice issued placing proceeding on Los Angeles, Calif., calendar. Service of answer and request made.

1946

Dec. 6—Hearing set Feb. 10, 1947, at Los Angeles, Calif.

1947

Jan. 31—Motion for extension of time to the next Los Angeles, calendar filed by petitioner. Granted 1/31/47.

Apr. 24—Hearing set 6/23/47—Los Angeles.

1947

June 30—Hearing had before Judge Kern on merits.

Briefs due 8/14/47. Replies due 8/29/47.

July 22—Transcript of hearing 6/30/47 filed.

July 29—Motion for extension to 8/31/47 to file brief filed by taxpayer 7/30/47 Granted.

Aug. 14—Brief filed by General Counsel.

Sept. 2—Brief filed by Taxpayer 9/3/47 copy served.

1948

Mar. 24—Memorandum findings of fact and opinion rendered. Kern—J. Decision will be entered for the Respondent 3/24/48. Copy served.

May 21—Motion to reopen case filed by Petitioner.

May 26—Order—granting petitioners motion to reopen case for further hearing—proceeding to be set at Los Angeles first calendar after 7/1/48—entered.

July 28—Hearing set October 11, 1948. Los Angeles, Calif.

Oct. 11—Hearing had before Judge Arundell, Petitioner's oral motion for continuance, motion for leave to amend pet. Motion granted. Continued to next calendar subsequent to Nov. 1948. 30 days leave granted to file amended petition. Respdt. allowed 15 days to answer.

Oct. 11—Order that the proceeding is continued to the next Los Angeles calendar subsequent to 11/29/48 entered.

Nov. 4—Transcript of hearing 10/11/48 filed.

1948

Nov. 12—Supplement and amendment to petition filed by petitioner. 11/12/48 copy served.

Dec. 1—Answer to petitioner's supplement and amendment to petition filed by respondent. 12/2/48 copy served.

Dec. 23—Hearing set Feb. 7, 1949, Los Angeles.

1949

Feb. 11-15—Hearing had before Judge Johnson on merits, petitioner's oral motion to amend petition and respondent's oral motion to amend answer—motions granted. Stipulation of facts, petitioner's trial memo of points and authorities, amendment to supplement and amendment to petition attached in file—copy served. Answer to second supplement and amendment to petition—copy served, petitioner's counsel's oral argument at hearing accepted as original brief. Respondent's brief 4/6/49—petitioner's reply brief 5/6/49.

Mar. 8—Transcript of hearing 2/11/49 filed.

Mar. 8—Transcript of hearing 2/15/49 filed.

Apr. 4—Motion for extension to 5/6/49 for respondent reply—and 30 day extension for pet.'s reply filed by General Counsel, 4/5/49 Granted.

May 2—Stipulation to correct transcript of record filed.

May 6—Brief filed by General Counsel.



1949

May 20—Motion for extension to June 26, 1949, to file reply brief filed by taxpayer. 5/25/49  
Granted.

Dec. 15—Findings of fact and opinion rendered.  
Johnson J. Decision will be entered under Rule 50—copy served.

1950

Jan. 24—Respondent's computation for entry of decision filed.

Feb. 8—Hearing set March 1, 1950, Wash., D. C., under Rule 50.

Mar. 1—Hearing had before Judge Disney on settlement—referred to Judge Johnson (Uncontested).

Mar. 3—Decision entered, Johnson J. Div. 10.

May 19—Petition for review by U. S. Ct. of Appeals for the 9th circuit and statements of points filed by General Counsel.

May 31—Proof of service of petition for review filed, on taxpayer and counsel for taxpayer.

June 19—Motion for extension of time to Aug. 17, 1950, to prepare and transmit the record filed by General Counsel.

June 19—Order enlarging the time to Aug. 17, 1950, to prepare and transmit the record entered.

July 6—Agreed notice of record on review filed.



Before  
The Tax Court of the United States

Docket No. 8720

BIRCH RANCH & OIL COMPANY, a Corpora-  
tion,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in Notice of Deficiency and Statement, L. A.: T.: 90D: P. B., dated April 30, 1945, and alleges as follows:

I. Petitioner is a corporation organized and existing under the laws of the State of Nevada with its principal office at 427 West Fifth Street, Los Angeles, California. The returns for the periods here involved were filed with the Collector of Internal Revenue for the Southern District of California at Los Angeles, California.

II. The said Notice of Deficiency and Statement, a copy of which is hereto attached marked "Exhibit A," was mailed to the petitioner on April 30, 1945.

III. The taxes in controversy are income and excess profit taxes for the fiscal years ending Sep-

tember 30, 1941, and September 30, 1942, and involve amounts as follows:

Year Ended	Liability	Assessed	Deficiency
	Income Tax		
9/30/41	\$ 7,833.44	None	\$ 7,833.44
9/30/42	11,915.67	None	11,915.67
Total	<u>\$19,749.11</u>	<u>None</u>	<u>\$19,749.11</u>
	Declared Value Excess-Profits Tax		
9/30/41	\$ 4,565.41	None	\$ 4,565.41
9/30/42	1,687.10	None	1,687.10
Total	<u>\$ 6,252.51</u>	<u>None</u>	<u>\$ 6,252.51</u>

The entire deficiency is in controversy for each of said years. Also, as hereinafter shown, petitioner is entitled to credits which would in any event offset the whole of such deficiency for each of said years.

IV. The determination of the taxes set forth in said notice of deficiency is based upon the following errors of the Commissioner:

(a) In holding that the petitioner's net income for both of said fiscal years is determined upon the cash receipts and disbursements basis, when in fact the petitioner's net income, since its organization on October 15, 1934, at all times has been and is determined upon an accrual basis of accounting.

(b) In disregarding the inventories covering petitioner's Conaway Ranch for each of said fiscal years upon the theory that the net income of said ranch is determined upon the cash receipts and disbursements basis, when in fact the net income of said ranch, and petitioner's entire system of

accounting, at all times has been and is determined upon an accrual basis.

(c) In holding that the income of petitioner's Etiwanda Citrus Ranch, and its system of accounting, for each of said fiscal years is upon the cash receipts and disbursements basis, when in fact the net income of said ranch, and petitioner's entire system of accounting, at all times has been and is determined upon an accrual basis.

(d) In disallowing petitioner's deduction for the year ending September 30, 1941, in the sum of \$120,000.00, except as to \$19,200.00 thereof, upon the theory that the same represents interest, when in fact the whole of such item of deduction represents, and is properly deductible as, taxes accrued to pay interest on \$2,000,000.00 of bonds issued by Reclamation District No. 2035, the principal of all of which bonds, with interest thereon, until paid constitutes a lien against petitioner's lands, and which interest accrues semi-annually as a lien and tax against petitioner's lands irrespective of the occurrence of any other event.

(e) In disallowing petitioner's deduction for the year ending September 30, 1942, in the sum of \$120,000.00, except as to \$19,200.00 thereof, upon the theory that the same represents interest, when in fact the whole of such item of deduction represents, and is properly deductible as, taxes accrued to pay interest on \$2,000,000.00 of bonds issued by Reclamation District No. 2035, which interest accrues semi-annually as a lien and tax against peti-

tioner's lands irrespective of the occurrence of any other event.

(f) In disallowing petitioner's net operating losses deducted by it in its income tax returns for the said taxable years ending September 30, 1941 and 1942, under the theory that such losses are not deductible under the provisions of Section 122 of the Internal Revenue Code.

(g) In disallowing the petitioner's deductions in its said income tax returns for each of said years for declared value excess profits for the erroneous reason that petitioner's net income is determined upon the cash receipts and disbursement basis when in fact, such net income is determined upon an accrual basis.

V. The facts upon which the petitioner relies as a basis for this proceeding are as follows:

(a) Petitioner was organized as a corporation on October 15, 1934; that at the time of its organization, petitioner adopted a fiscal year commencing on October 1 and ending on September 30, and a system of accounting upon an accrual basis; that petitioner has not since changed said fiscal year or its said system of accounting; that ever since said date of organization the petitioner has entered upon its books of account all accounts receivable and accounts payable when and as the same accrued and made its income tax returns upon said accrual basis of accounting. That the Commissioner has nevertheless disallowed the various items as set forth in said deficiency notice and statement (hereto at-

tached as Exhibit "A"), and as hereinafter referred to, upon the erroneous theory that petitioner's system of accounting is upon a cash basis.

(b) Ever since its said date of organization petitioner has owned and operated a ranch known as the Conaway Ranch; that all transactions concerning the operation of said ranch have been entered in a separate set of books; that at the time of petitioner's organization it adopted an accrual system of accounting for the said ranch and petitioner has not since changed its said system of accounting; that ever since said date petitioner has entered upon its books of account concerning said ranch all accounts receivable and all accounts payable when and as the same accrued and the petitioner has determined its net income from said ranch and all of its net income upon said accrual basis of accounting. That the Commissioner has nevertheless disallowed the various items relating to said Conaway Ranch as set forth in said deficiency notice and statement (hereto attached as Exhibit "A") upon the theory that this petitioner's system of accounting with relation to said ranch is upon a cash basis.

(c) Ever since its said date of organization petitioner has owned and operated what is known as the Etiwanda Citrus Ranch; that at the time of petitioner's organization it adopted an accrual system of accounting for the said ranch and petitioner has not since changed its said system of accounting; that ever since said date petitioner has entered upon its books of account concerning said ranch all accounts receivable and all accounts payable when



and as the same accrued and the petitioner has determined its net income from said ranch and all of its net income upon said accrual basis of accounting; that the Commissioner has nevertheless treated this petitioner's system of accounting as if said system with relation to said ranch were upon a cash basis.

(d)1. Ever since prior to the year 1872 it has been the policy of the State of California to encourage the development of marginal and undeveloped swamp and overflowed lands by providing for the formation of reclamation districts, constituting municipal corporations as separate legal entities, and by providing for the financing of such districts by the issuance of reclamation bonds with liberal payment and tax exemption privileges, and other privileges, and by providing that the principal and interest of such bonds shall constitute a first and prior lien until paid upon all of the lands of such districts.

2. In reliance upon the said policy and the laws of said State for the encouragement of the development of said marginal lands, the petitioner's predecessors in interest in the ownership of the said Conaway Ranch and other owners of land in the vicinity thereof, on or about April 8, 1919, caused to be created and said lands to be included in Reclamation District No. 2035 of the State of California; that said reclamation district consists of approximately 22,000 acres located in Yolo County, California, and it ever since has been and now is

a bona fide duly organized and existing reclamation district of said State.

3. At the said time of said organization of said district the landowners of said district transferred by deed to said district, rights of way and lands for roads, levees, ditches, pumping plants and warehouses, hereinafter referred to as said property; that said district as a separate entity ever since has been and now is the owner of said property.

4. Commencing immediately after the formation of said district the said district caused said property to be improved by the construction of approximately forty-five miles of roadways, forty-seven miles of irrigation canals, fifty-five miles of drainage canals and ditches, together with bridges, pumping plants, warehouses and other structures usual and necessary for the development and operation of such a district; that said improvements were completed prior to 1925 at a cost slightly in excess of the sum of \$2,000,000.00.

5. In order to pay for the cost of said improvements and pursuant to the provisions of Section 3457 of the Political Code of the State of California, the said district duly caused to be issued a bond issue in the sum of \$2,000,000.00 covering all of the lands of said district; that said bonds are each dated January 21, 1925, and each bear interest at the rate of 6% per annum, payable on the 1st day of January and the 1st day of July of each and every year until paid, and said bonds mature each year in series commencing on the 1st day of

January, 1935, up to and including January 1st, 1943; that under the laws of said State the said interest accrues in the manner aforesaid and becomes a tax lien against the petitioner's land irrespective of any act of said Reclamation District or of any call by the County Treasurer, and said interest remains a tax lien upon the whole of petitioner said Conaway Ranch until paid.

6. Between 1925 and 1934 two of petitioner's predecessors in interest, to wit: A. Otis Birch and wife, acquired the title to the whole of the said Conaway Ranch and they also acquired all of the other parcels of land comprising said district, except one small parcel, and caused such additional parcels so acquired to be and become a part of said Conaway Ranch; that between said dates said Birch and wife also acquired the ownership of a large majority of said bonds; that ever since 1934 except for said one parcel of land, and except for said property of said district, said Conaway Ranch has comprised the entire area of said district.

7. With respect to their income tax returns for each year between 1925 and 1934 said Birch and wife adopted the practice of deducting, and they did deduct, said item of \$120,000.00 as taxes, the same representing an amount sufficient to pay the total annual interest accruing upon said \$2,000,000.00 of bonds; also in said income tax returns for each of said years said Birch and wife did not account for or include as part of their gross income, any part of the interest received by them from any of said bonds upon the theory that such income was



exempt from taxation under the laws of the State of California.

8. The Commissioner questioned each of said deductions for each of said years and said failure to include said income from said bonds, and in each instance, after investigation and consideration, the Commissioner approved each of said deductions and said failure to include said income.

9. Ever since the said development of said district said Conaway Ranch has been operated as a farm in the raising of rice and sheep and other farm products. Such operations require current financing in a sum substantially in excess of \$100,000.00 per year. After the commencement of the depression in 1929, A. Otis Birch and wife found it inconvenient to advance such current financing and they found it necessary and desirable to borrow money for such purpose. On attempting so to do, they found it then was the policy of all financial institutions not to loan such sums of money to individual persons and that it was impossible for them to borrow any substantial sum from such institutions, or at all, unless they should place a substantial part of their property in a corporate form of ownership.

10. Solely for the purpose of obtaining said current financing, and other financing, and for the purpose of enjoying the legitimate advantages of a corporate form of organization, said Birch and wife caused the petitioner herein to be incorporated on the 15th day of October, 1934, in the State of Nevada. On the same date and for the same reasons

and as part of a convenient corporate set-up for the proper segregation of their properties, they also caused to be incorporated the Birch Securities Company, a corporation of the State of Nevada, and the Birch Holding Company, a corporation of the State of Delaware. Said Birch and wife thereupon transferred all of the aforesaid bonds owned by them to said Birch Securities Company and the whole of said Conaway Ranch, together with a portion of all other properties owned by them, to the petitioner herein. The petitioner and said Birch Securities Company thereupon issued all of their respective authorized capital stock and transferred the same to the Birch Holding Company and said Birch Holding Company thereupon issued all of its capital stock and transferred 49% thereof to A. Otis Birch and 51% thereof to M. Estelle C. Birch, his wife, each of which persons owned all of said capital stock during the fiscal years involved herein.

11. The organization of all of said companies was made in good faith and was bona fide in every respect and said organization was not made with a view to affecting in any manner the obligation of said Birch and wife, or of any of said companies, to pay taxes of any kind or character, nor was it made for the purpose of enabling petitioner to take the deductions involved herein for taxes paid to said reclamation district, since the said Birch and wife for approximately eight years prior to the organization of said companies had been after full consideration by the Commissioner, as aforesaid,

permitted to take said deductions from their income tax returns for each of said years.

12. Since its incorporation the petitioner has borrowed various sums of money from various banks and other financial institutions to the extent of substantially in excess of \$100,000.00 a year. The petitioner has ever since its organization engaged in the business of operating said ranch and of developing oil wells and other enterprises as a separate legal entity separate and apart from the activities and obligations of said Birch and wife and of said other companies. Ever since its organization petitioner has had its separate creditors, separate and apart from said Birch and wife and said other companies, and said financial institutions and various other creditors have extended credit to the petitioner in reliance upon the fact that the petitioner is a separate corporate entity which is responsible for the payment of no obligations, including taxes, other than its own.

13. Petitioner is in fact a separate legal and corporate entity and it is not in any respect the alter ego of said Birch and wife or of said other corporations, or any of them, or of any other person or corporation, and its organization, and the afore-said set-up, are legitimate and bona fide in every respect.

14. On October 15, 1934, the ownership of said bond issue was as follows:

Republic Life Insurance Company.....	\$ 86,000.00
Lula M. Minter.....	10,000.00
The Hopkins .....	309,000.00
A. Otis Birch and wife.....	1,595,000.00
<hr/>	
Total .....	\$2,000,000.00

15. That during 1941 and 1942 the ownership of said bonds was as aforesaid except that the Birch Securities Company on October 15, 1934, acquired the aforesaid bonds owned by A. Otis Birch and wife, of the said face value of \$1,595,000.00, and except that in 1940 this petitioner acquired said bonds owned by said Republic Life Insurance Company of the face value of \$86,000.00; that except as aforesaid, this petitioner has not owned, and does not now own, any of said bonds.

16. On October 6, 1934, an election was duly held in said Reclamation District No. 2035 for the refunding of all said bonds, pursuant to the provisions of said Section 3480. At said election the issuance of 2,000 new bonds in the place of said old bonds was duly authorized. Said new bonds mature as stated in said Notice of Election and they are in like number and amount as said old bonds and they likewise bear interest at 6% to the end that such new bonds when issued take the place of said old bonds and to the end that interest upon the entire principal of said bond issue is continuous and a first and prior lien against all of the lands of the said district until said bonds are paid.

17. On or about 1942 said new bond issue was



issued in the place of said old bonds. Pursuant to the provisions of said Section 3480 the said lands are subject to a lien of continuously accumulating interest at said rate of 6%, whether said interest accrues from said old bonds or said new bonds, and until said sum of \$2,000,000.00 is paid that all of said bonds are outstanding and unpaid.

18. Since 1925 the petitioner and its said predecessors in interest, in exchange for the use of said property of said district, including said warehouses, has paid all expenses for the operation of said district, so that the only expense which said district has and for which it need raise any taxes is the payment of said interest on said bonds in the sum of \$120,000.00 per year. By reason of these facts the amount of said Reclamation District tax against petitioner's land is exactly said sum of \$120,000.00 a year, which sum accrues solely by reason of the existence of said bonds and irrespective of the occurrence of any other event.

19. That at all times since its said organization petitioner has paid in cash to the County Treasurer of said Yolo County, or to the bondholders of said bond issue in exchange for an equivalent amount of interest coupons of said bonds, an amount of money or interest coupons sufficient to pay the taxes to meet the interest upon all of said bonds promptly as such interest became due, except that from 1936, up to and including the year 1940, this petitioner did not pay the amount of money necessary to meet the interest coupons as the same accrued upon the

aforesaid bonds owned and held by said Birch Securities Company; that petitioner did not make said payments for the reason, among others, that in 1937 the Birch Securities Company became, and ever since has been, suspended by the Franchise Tax Commissioner of the State of California for alleged non-payment of certain California State Franchise taxes; that under the laws of the State of California, the said Birch Securities Company, during the existence of said suspension until 1941, was prohibited from delivering any of the interest coupons of said bonds owned by it, or from accepting any money therefor under penalty of a criminal prosecution, a severe fine, and possible imprisonment of its officers; that on June 9, 1941, said Birch Securities Company, through its president, A. Otis Birch, in an action entitled, A. Otis Birch vs. Charles J. McColgan, as Franchise Tax Commissioner of the State of California, the same being cause No. 1430B of the District Court of the United States for the Southern District of California, received an opinion from said court, sitting as a three-judge statutory court, to the effect that said suspension of Birch Securities Company was wrongful and void (39 Fed. Supp. 358); that thereafter a permanent injunction was issued by said three-judge statutory court prohibiting said Franchise Tax Commissioner from maintaining said suspension; that thereafter other obstacles which had prevented this petitioner from obtaining said coupons from said Birch Securities Company also became removed, and thereafter, to wit: commencing

prior to October 1, 1943, and including the whole of the said fiscal years involved herein, this petitioner commenced to pay money sufficient to meet the interest on all of said bonds, including the said bonds of the said Birch Securities Company; that in every instance where this petitioner has paid money directly to said bondholders in exchange for interest coupons of said bonds, this petitioner has deposited said interest coupons with the County Treasurer of said county as the equivalent of money for the payment of said taxes; that the laws of the State of California permit and expressly provide that the taxes of a reclamation district may be paid in such manner.

20. Upon its books of account, petitioner included, for its fiscal year ending September 30, 1941, items of interest payable and paid on said bonds as taxes to said district in the sum of \$120,000.00. In its income tax return for said year, petitioner deducted said sum of \$120,000.00 as taxes accrued. Said deduction is a proper item of deduction for said purpose. Notwithstanding the facts aforesaid, the Commissioner erroneously disallowed said item in said Notice of Deficiency and Statement.

(e)1. Petitioner hereby incorporates paragraphs (d)1 to (d)20 hereof as part of this paragraph.

2. Upon its books of account, petitioner included for the fiscal year ending September 30, 1942, items of interest payable and paid on said bonds as taxes to said district in the sum of \$120,000.00 In its

income tax return for said year, petitioner deducted said sum of \$120,000.00 as taxes accrued. Said deduction in a proper item of deduction for said purpose. Notwithstanding the facts aforesaid, the Commissioner erroneously disallowed said item in said Notice of Deficiency and Statement.

(f)1. Petitioner hereby incorporates paragraphs (d)1 to (d)20 hereof as part of this paragraph.

2. That in its income tax returns for the years ending September 30, 1941 and 1942, the petitioner deducted operating losses in the sums of \$184,085.69 and \$143,714.15, respectively, as shown by the Commissioner's said Notice of Deficiency and Statement; that said operating losses, and each and every item thereof, were actual operating losses and proper items of deduction; that notwithstanding the facts aforesaid the Commissioner disallowed all of said operating losses upon the erroneous theory that petitioner's net income is determined upon the cash receipts and disbursements basis when in fact said net income should have been and is determined upon said accrual basis.

(g)1. Petitioner hereby incorporates paragraphs (d)1 and (d)20 hereof as part of this paragraph.

2. That by reason of the facts aforesaid, in its said income tax returns for the years ending September 30, 1941 and 1942, the petitioner made no declared value of excess profit tax assessed; that notwithstanding the facts aforesaid the Commissioner in said Notice of Deficiency and Statement erroneously assessed against this petitioner a deficiency of declared value excess profit taxes in the



sums of \$4,565.41 and \$1,687.10, respectively, upon the erroneous theory that petitioner's net income is determined upon the cash receipts and disbursements basis when in fact said net income should have been and is determined upon said accrual basis.

(h) That during petitioner's fiscal year ending September 30, 1943, petitioner suffered a loss by reason of non-payment of a loan made by it to the Birch-Smith Storage Company, a California corporation, operated and owned independently of said A. Otis Birch and wife, in the sum of \$52,031.26; that during said year petitioner also suffered a loss of a loan made to one Edna Tiller in the sum of \$200.00; that during said year petitioner also suffered a loss by reason of an unpaid loan made to Mrs. A. E. Dye; that in its income tax return for said year, petitioner listed and deducted said items of loss in the total sum of \$52,481.26; that should this court deny any part of this petitioner's petition herein, this petitioner desires to carry back to its fiscal years ending September 30, 1941 and 1942, as much of said sum of \$52,481.26 up to \$12,000.00 thereof, as may be necessary to offset any part of the said tax deficiencies involved herein.

(i) That during petitioner's fiscal year ending September 30, 1944, petitioner suffered a loss in the sum of \$73,556.88 by reason of the drilling and abandonment of an oil well known as the Stovall-Wilcoxson well, and the leasehold interest in connection therewith; that in the same year this

petitioner suffered losses from sales of property other than capital assets as follows:

A 338-acre farm situated in Stanislaus

County, California .....	\$36,417.50
Lots 61, 112, 141, Tract 993.....	1,160.00
Lots 32, 36, 60, 91, Tract 993.....	1,520.00
Lots 87, 62, 189, 90, 108, Tract 993.....	1,730.00
Lot 201, Tract 993.....	1,200.00
Store Building, 320 Venice Blvd., Los Angeles .....	5,500.00

that in its income tax return for said year petitioner listed and deducted all of the aforesaid items of loss in the total sum of \$121,084.38; that should this court deny any part of this petitioner's petition herein this petitioner desires to carry back to its fiscal year ending September 30, 1942, as much of said losses in the said sum of \$121,084.38, up to \$25,000.00 thereof, as may be necessary to offset any part of the said tax deficiencies involved herein.

Wherefore, petitioner prays that this court hear this proceeding and that the petitioner be granted relief as follows:

(a) That this court adjudge and declare that this petitioner's net income, and its system of accounting, for said fiscal years ending September 30, 1941 and 1942, and for all years, has been and is determined upon an accrual basis.

(b) That this court adjudge and declare that this petitioner's net income, and its system of accounting relating to said Conaway Ranch for each of said years, and for all years, is determined upon an accrual basis.

(c) That this court adjudge and declare that this petitioner's net income, and its system of accounting, relating to said Etiwanda Citrus Ranch, for each of said years, and for all years, is determined upon an accrual basis.

(d) That this court determine that the petitioner is entitled to a deduction in the full sum of \$120,000.00, accrued as taxes for payment of interest upon bonds of Reclamation District 2035 of the State of California for the fiscal year ending September 30, 1941.

(e) That this court determine that the petitioner is entitled to a deduction in the full sum of \$120,000.00, accrued as taxes for payment of interest upon bonds of Reclamation District 2035 of the State of California for the fiscal year ending September 30, 1942.

(f) That this court determine that this petitioner is entitled to deduct the operating losses as deducted by it in its income tax returns for the said taxable years ending September 30, 1941 and 1942, and as disallowed by the Commissioner in said Notice of Deficiency and Statement.

(g) That this court determine that this petitioner's failure to include in its said income tax returns for each of said years any declared value excess profits is proper, and that the Commissioner's assessed deficiencies therefor, are erroneous and improper.

(h) That should this court deny any part of this petitioner's petition herein that petitioner be adjudged entitled to carry back to its fiscal years

ending September 30, 1941 and 1942, as much of said sum of \$52,481.26, up to \$12,000.00 thereof, as may be necessary to offset any part of the said tax deficiencies involved herein.

(i) That should this court deny any part of this petitioner's petition herein that petitioner be adjudged entitled to carry back to its fiscal year ending September 30, 1942, as much of said losses in the said sum of \$121,084.38, up to \$25,000.00 thereof, as may be necessary to offset any part of the said deficiencies involved herein.

(j) That this court disallow and redetermine all of the said deficiencies as determined by the Commissioner in said Notice of Deficiency and Statement.

GEORGE ACRET,

/s/ GEORGE ACRET,

Attorney for Petitioner.

State of California,

County of Los Angeles—ss.

R. R. Landrum, being duly sworn, says that he is the Secretary of the petitioner and that he is duly authorized to verify the foregoing petition in behalf of the petitioner; that he has read the foregoing petition and is familiar with the statements contained therein and that all of the statements contained therein are true except those stated to be upon information and belief, and all of such statements he believes to be true.

R. R. LANDRUM.

/s/ R. R. LANDRUM.

Subscribed and sworn to before me this 10th day of July, 1945.

[Seal]      /s/ GEORGE ACRET,  
Notary Public in and for the County of Los Angeles, State of California.

Exhibit "A"

Form 1279

[Emblem]

Office of

Internal Revenue Agent in Charge

Los Angeles Division

LA:IT:90D:PB.

Treasury Department  
Internal Revenue Service,  
417 South Hill Street,  
Los Angeles 13, California

Apr. 30, 1945.

Birch Ranch & Oil Co.,  
427 West 5th Street,  
Los Angeles 13, California.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable years ended September 30, 1941 and 1942, disclose a deficiency of \$19,749.11, and that the determination of your declared value excess-profits tax liability for the taxable years mentioned discloses a deficiency of \$6,252.51, as shown in the statement attached.

In accordance with the provisions of existing in-



ternal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,  
Commissioner,

By GEORGE D. MARTIN,  
Internal Revenue Agent  
in Charge.

Enclosures:

Statement

Form of waiver

Statement

LA :IT :90D :PB

Birch Ranch & Oil Co.  
427 West 5th Street  
Los Angeles 13, California

Tax Liability for the Taxable Years  
Ended September 30, 1941, and September 30, 1942

Year Ended	Liability	Assessed Income Tax	Deficiency
9/30/41	\$ 7,833.44	None	\$ 7,833.44
9/30/42	11,915.67	None	11,915.67
Total	\$19,749.11	None	\$19,749.11
	Declared Value-Excess Tax		
9/30/41	\$ 4,565.41	None	\$ 4,565.41
9/30/42	1,687.10	None	1,687.10
Total	\$ 6,252.51	None	\$ 6,252.51

In making this determination of your tax liability careful consideration has been given to the report of examination dated January 27, 1945.

No deduction is allowed herein for declared value excess profits tax because your net income is determined upon the cash receipts and disbursements basis and no declared value excess-profits tax was paid in either of the taxable years herein.

Adjustments to Net Income

Taxable Year Ended September 30, 1941

Net income (loss) as disclosed by return		(\$ 93,811.44)
Unallowable deductions:		
(a) Taxes	\$100,623.73	
Forwarded:	\$100,623.73	(\$ 93,811.44)
2—Birch Ranch & Oil Co.		Statement
Brought forward:	\$100,623.73	(\$ 93,811.44)
(b) Interest	2,075.32	
(c) Net operating loss deduction	81,386.64	184,085.69
Total		\$ 90,274.25
Reductions in income:		
(d) Partnership loss	\$ 32,221.63	
(e) Conaway Ranch income	20,154.64	
(f) Etiwanda Citrus Ranch income	186.70	
(g) Compensation for services	3,000.00	55,563.01
Net income adjusted		\$ 34,711.24

## Explanation of Adjustments

(a) The deduction (claimed as taxes) of \$120,000.00 interest on \$2,000,000.00 of bonds issued by Reclamation District No. 2035 is disallowed except as to \$19,200.00 paid to the Hopkins sisters and Miss Minter. The disallowed amount of \$100,800.00 is reduced to \$100,623.73 by allowance of an additional amount of \$176.27 real estate taxes.

(b) Interest on indebtedness incurred or continued to purchase or carry obligations the interest upon which is wholly exempt from tax is disallowed. Section 23(b) of the Internal Revenue Code.

(c) There is no amount of net operating loss deduction allowable for this taxable year under the provisions of section 122 of the Internal Revenue Code.

(d) You failed to claim a deduction for your distributive share of loss of the partnership Birch-Royer Oil Company, for the taxable year ended December 31, 1940, the amount of which has been determined as \$32,221.63.

(e) The following adjustments are made in the computation of Conaway Ranch income:

Decreases:		
1. Closing inventory eliminated		\$69,522.43
2. Depreciation of breeding sheep		5,426.51
	Total	<hr/> \$74,948.94
Forwarded:		\$74,948.94
3—Birch Ranch & Oil Co.		Statement
Brought forward:		<hr/> \$74,948.94
Increases:		
3. Opening inventory eliminated	\$44,660.90	
4. Cost of breeding sheep disallowed	10,133.36	54,794.26
		<hr/>
Net decrease		\$20,154.68

1 and 3. Inventories are disregarded because the Conaway Ranch net income is determined upon the cash receipts and disbursements basis.

2 and 4. The cost of breeding sheep purchased in the taxable year is disallowed as representing a capital expenditure, \$10,133.36, and depreciation is allowed on the cost of breeding sheep purchased in prior years and the taxable year in the amount of \$5,426.51.

(f) Income of Etiwanda Citrus Ranch is reduced \$186.70 due to the elimination of closing inventory of fruit produced. The net income of Etiwanda Citrus Ranch is determined upon the cash receipts and disbursements basis.

(g) An additional deduction of \$3,000.00 is allowed for compensation of services rendered by George W. Clemson, this amount having been paid in the taxable year and your net income being determined upon the cash receipts and disbursements basis.



Computation of Declared Value Excess-Profits Tax

Taxable Year Ended September 30, 1941

Net income \$34,711.24

Less: 10% of \$999.00, value of capital stock as declared in your capital stock tax return for the year ended June 30, 1941 99.90

Net income subject to declared value excess-profits tax \$34,611.34  
 5% of declared value of capital stock 49.95

Balance \$34,561.39

4—Birch Ranch & Oil Co. Statement

Declared value excess-profits tax:

6 % of \$ 49.95 \$ 3.00  
 12% of \$34,561.39 4,147.37

Total \$4,150.37  
 Plus: Defense tax (10% of \$4,150.37) 415.04

Correct declared value excess-profits tax liability \$ 4,565.41

Declared value excess-profits tax assessed:  
 Original, account No. 850019 None

Deficiency of declared value excess-profits tax \$ 4,565.41

Computation of Income Tax

Taxable Year Ended September 30, 1941

Net income \$34,711.24

Normal-tax net income \$34,711.24

Income tax:

Tax on \$25,000.00 \$3,775.00  
 35% of \$ 9,711.24 3,398.93

Total \$7,173.93  
 Plus: Defense tax (1.9% of \$34,711.24) 659.51

Correct income tax liability \$ 7,833.44

Income tax assessed: Original, account No. 850019 None

Deficiency of income tax \$ 7,833.44

## 5—Birch Ranch &amp; Oil Co.

Statement

Adjustments to Net Income  
Taxable Year Ended September 30, 1942

Net income (loss) as disclosed by return (\$ 53,475.88)

## Unallowable deductions:

(a) Taxes	\$102,423.24	
(b) Interest	1,869.63	
(c) Partnership loss	32,221.63	
(d) Compensation for services	7,200.00	143,714.50

Total		\$ 90,238.62
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## Reductions in income:

(e) Conaway Ranch income	\$ 45,341.54	
(f) Etiwanda Citrus Ranch income	7,116.00	52,457.54

Net income adjusted		\$ 37,781.08
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## Explanation of Adjustments

(a) The deduction (claimed as taxes) of \$120,000.00 interest on \$2,000,000.00 of bonds issued by Reclamation District No. 2035 is disallowed except as to \$18,990.00 paid to the Hopkins sisters and Miss Minter. A further disallowance of \$1,413.24 is made on account of an excessive deduction for real estate taxes.

(b) Interest on indebtedness incurred or continued to purchase or carry obligations the interest upon which is wholly exempt from tax is disallowed. Section 23(b) of the Internal Revenue Code.

(c) The deduction of \$32,221.63 claimed as your distributive share of loss of the partnership Birch-Royer Oil Company for its taxable year ended December 31, 1940, is disallowed. The deduction has been allowed for your taxable year ended September 30, 1941.

(d) The deduction of \$7,200.00 claimed for compensation paid prior to the taxable year for services of George W. Clemson is disallowed because the amount was paid prior to the taxable year and your net income is determined upon the cash receipts and disbursements basis.

(e) The following adjustments are made in the computation of Conaway Ranch income:

## 6—Birch Ranch &amp; Oil Co.

Statement

## Decreases:

1. Closing inventory eliminated	\$110,996.99
2. Depreciation of breeding sheep	3,866.98

Total	\$114,863.94
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## Increase:

3. Opening inventory eliminated	69,522.43
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Net decrease	\$ 45,341.51
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1 and 3. Inventories are disregarded because the Conaway Ranch net income is determined upon the cash receipts and disbursements basis.

2. Depreciation is allowed on the cost of breeding sheep purchased in prior years in the amount of \$3,866.98.

(b) Income of Etiwanda Citrus Ranch is reduced \$7,116.00 due to the elimination of inventories of fruit produced—\$7,302.70 at the close of the year and \$186.70 at the beginning of the year. The net income of Etiwanda Citrus Ranch is determined upon the cash receipts and disbursements basis.

Computation of Declared Value Excess-Profits Tax

Taxable Year Ended September 30, 1942

Net income		\$37,781.08
Less: 10% of \$200,000.00, value of capital stock as declared in your capital stock tax return for the year ended June 30, 1942		20,000.00
		<hr/>
Net income subject to declared value excess-profits tax		\$17,781.08
5% of declared value of capital stock		10,000.00
		<hr/>
Balance		\$ 7,781.08
Declared value excess-profits tax:		
6.6% of \$10,000.00	\$ 660.00	
13.2% of \$ 7,781.08	1,027.10	
	<hr/>	
Correct declared value excess-profits tax liability		\$ 1,687.10
Forwarded:		\$ 1,687.10
7—Birch Ranch & Oil Co.		Statement
Brought forward:		\$ 1,687.10
Declared value excess-profits tax assessed:		
Original, account No. 10467		None
		<hr/>
Deficiency of declared value excess-profits tax		\$ 1,687.10

Computation of Income Tax  
Taxable Year Ended September 30, 1942

## Tentative tax under section 108(a) (1) (A), I. R. C.

1. Net income			\$37,781.08
2. Normal-tax net income			\$37,781.08
3. Surtax net income			\$37,781.08
4. Income tax:			
Normal tax:			
Tax on \$25,000.00	\$4,250.00		
37% of \$12,781.08	4,729.00	\$	8,979.00
Surtax:			
Tax on \$25,000.00	\$1,500.00		
7% of \$12,781.08	894.68		2,394.68
5. Tentative tax			\$11,373.68

## Tentative tax under section 108(a) (1) (B), I. R. C.

6. Net income			\$37,781.08
7. Normal-tax net income			\$37,781.08
8. Surtax net income			\$37,781.08
9. Income tax:			
Normal tax:			
Tax on \$25,000.00	\$4,250.00		
31% of \$12,781.08	3,962.13	\$	8,212.13
Surtax:			
Tax on \$25,000.00	\$2,500.00		
22% of \$12,781.08	2,811.84		5,311.84
10. Tentative tax under section 108(a) (1) (B)			\$13,523.97
8—Birch Ranch & Oil Co.			Statement
Income tax under section 108(a) (1), I. R. C.			
11. Number of days in taxable year			365
12. Number of days before July 1, 1942			273
13. Number of days after June 30, 1942			92
14. Portion of item 5 which item 12 bears to item 11 ( $\$11,373.68 \times 273/365$ )		\$	8,506.89
15. Portion of item 10 which item 13 bears to item 11 ( $\$13,523.97 \times 92/365$ )			3,408.78
16. Correct income tax liability			\$11,915.67
17. Income tax assessed: Original, account No. 10467			None
18. Deficiency of income tax			\$11,915.67

Received and filed T. C. U. S. July 13, 1945.

[Title of Tax Court and Cause.]

### AMENDED PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in Notice of Deficiency and Statement, L. A.: T.: 90:P. B., dated April 30, 1945, and alleges as follows:

I. Petitioner is a corporation organized and existing under the laws of the State of Nevada with its principle office at 427 West Fifth Street, Los Angeles, California. The returns for the periods here involved were filed with the Collector of Internal Revenue for the Southern District of California at Los Angeles, California.

II. The said Notice of Deficiency and Statement, a copy of which is hereto attached marked "Exhibit A," was mailed to the petitioner on April 30, 1945.

III. The taxes in controversy are income and excess profit taxes for the fiscal years ending September 30, 1941, and September 30, 1942, and involve amounts as follows:

Year Ended	Liability	Assessed	Deficiency
	Income Tax		
9/30/41	\$ 7,833.44	None	\$ 7,833.44
9/30/42	11,915.67	None	11,915.67
Total	\$19,749.11	None	\$19,749.11
	Declared Value Excess-Profits Tax		
9/30/41	\$ 4,565.41	None	\$ 4,565.41
9/30/42	1,687.10	None	1,687.10
Total	\$ 6,252.51	None	\$ 6,252.51



The entire deficiency is in controversy for each of said years. Also, as hereinafter shown, petitioner is entitled to credits which would in any event offset the whole of such deficiency for each of said years.

IV. The determination of the taxes set forth in said notice of deficiency is based upon the following errors of the Commissioner:

(a) In holding that the petitioner's net income for both of said fiscal years is determined upon the cash receipts and disbursements basis, when in fact the petitioner's net income, since its organization on October 15, 1934, at all times has been and is determined upon an accrual basis of accounting.

(b) In disregarding the inventories covering petitioner's Conaway Ranch for each of said fiscal years upon the theory that the net income of said ranch is determined upon the cash receipts and disbursements basis, when in fact the net income of said ranch, and petitioner's entire system of accounting, at all times has been and is determined upon an accrual basis.

(c) In holding that the income of petitioner's Etiwanda Citrus Ranch, and its system of accounting, for each of said fiscal years is upon the cash receipts and disbursements basis, when in fact the net income of said ranch, and petitioner's entire system of accounting, at all times has been and is determined upon an accrual basis.

(d) In disallowing petitioner's deduction for the year ending September 30, 1941, in the sum of

\$120,000.00, except as to \$19,200.00 thereof, upon the theory that the same represents interest, when in fact the whole of such item of deduction represents, and is properly deductible as, taxes accrued to pay interest on \$2,000,000.00 of bonds issued by Reclamation District No. 2035, the principal of all of which bonds, with interest thereon, until paid constitutes a lien against petitioner's lands, and which interest accrues semi-annually as a lien and tax against petitioner's lands irrespective of the occurrence of any other event.

(e) In disallowing petitioner's deduction for the year ending September 30, 1942, in the sum of \$120,000.00, except as to \$19,200.00 thereof, upon the theory that the same represents interest, when in fact the whole of such item of deduction represents, and is properly deductible as, taxes accrued to pay interest on \$2,000,000.00 of bonds issued by Reclamation District No. 2035, which interest accrues semi-annually as a lien and tax against petitioner's lands irrespective of the occurrence of any other event.

(f) In disallowing petitioner's net operating losses deducted by it in its income tax returns for the said taxable years ending September 30, 1941 and 1942, under the theory that such losses are not deductible under the provisions of Section 122 of the Internal Revenue Code.

(g) In disallowing the petitioner's deductions in its said income tax returns for each of said years for declared value excess profits for the erroneous reason that petitioner's net income is determined

upon the cash receipts and disbursements basis when in fact, such net income is determined upon an accrual basis.

V. The facts upon which the petitioner relies as a basis for this proceeding are as follows:

(a) Petitioner was organized as a corporation on October 15, 1934; that at the time of its organization, petitioner adopted a fiscal year commencing on October 1 and ending on September 30, and a system of accounting upon an accrual basis; that petitioner has not since changed said fiscal year or its said system of accounting: that ever since said date of organization the petitioner has entered upon its books of account all accounts receivable and accounts payable when and as the same accrued and petitioner has determined its net income and made its income tax returns upon said accrual basis of accounting. That the Commissioner has nevertheless disallowed the various items as set forth in said deficiency notice and statement (hereto attached as Exhibit "A"), and as hereinafter referred to, upon the erroneous theory that petitioner's system of accounting is upon a cash basis.

(b) Ever since its said date of organization petitioner has owned and operated a ranch known as the Conaway Ranch; that all transactions concerning the operation of said ranch have been entered in a separate set of books; that at the time of petitioner's organization it adopted an accrual system of accounting for the said ranch and petitioner has not since changed its said system of accounting; that ever since said date petitioner has entered upon its



books of account concerning said ranch all accounts receivable and all accounts payable when and as the same accrued and the petitioner has determined its net income from said ranch and all of its net income upon said accrual basis of accounting. That the Commissioner has nevertheless disallowed the various items relating to said Conaway Ranch as set forth in said deficiency notice and statement (hereto attached as Exhibit "A") upon the theory that this petitioner's system of accounting with relation to said ranch is upon a cash basis.

(c) Ever since its said date of organization petitioner has owned and operated what is known as the Etiwanda Citrus Ranch; that at the time of petitioner's organization it adopted an accrual system of accounting for the said ranch and petitioner has not since changed its said system of accounting; that ever since said date petitioner has entered upon its books of account concerning said ranch all accounts receivable and all accounts payable when and as the same accrued and the petitioner has determined its net income from said ranch and all of its net income upon said accrual basis of accounting; that the Commissioner has nevertheless treated this petitioner's system of accounting as if said system with relation to said ranch were upon a cash basis.

(d)1. Ever since prior to the year 1872 it has been the policy of the State of California to encourage the development of marginal and undeveloped swamp and overflowed lands by providing for the formation of reclamation districts, constitut-

ing municipal corporations as separate legal entities, and by providing for the financing of such districts by the issuance of reclamation bonds with liberal payment and tax exemption privileges, and other privileges, and by providing that the principal and interest of such bonds shall constitute a first and prior lien until paid upon all of the lands of such districts.

2. In reliance upon the said policy and the laws of said State for the encouragement of the development of said marginal lands, the petitioner's predecessors in interest in the ownership of the said Conaway Ranch and other owners of land in the vicinity thereof, on or about April 8, 1919, caused to be created and said lands to be included in Reclamation District No. 2035 of the State of California; that said reclamation district consists of approximately 22,000 acres located in Yolo County, California, and it ever since has been and now is a bona fide duly organized and existing reclamation district of said State.

3. At the said time of said organization of said district the landowners of said district transferred by deed to said district, rights of way and lands for roads, levees, ditches, pumping plants and warehouses, hereinafter referred to as said property; that said district as a separate entity ever since has been and now is the owner of said property.

4. Commencing immediately after the formation of said district the said district caused said property to be improved by the construction of approxi-

mately forty-five miles of roadways, forty-seven miles of irrigation canals, fifty-five miles of drainage canals and ditches, together with bridges, pumping plants, warehouses and other structures usual and necessary for the development and operation of such a district; that said improvements were completed prior to 1925 at a cost slightly in excess of the sum of \$2,000,000.00.

5. In order to pay for the cost of said improvements and pursuant to the provisions of Section 3457 of the Political Code of the State of California, the said district duly caused to be issued a bond issue in the sum of \$2,000,000.00 covering all of the lands of said district; that said bonds are each dated January 21, 1925, and each bear interest at the rate of 6% per annum, payable on the 1st day of January and the 1st day of July of each and every year until paid, and said bonds mature each year in series commencing on the 1st day of January, 1935, up to and including January 1st, 1943; that under the laws of said State the said interest accrues in the manner aforesaid and becomes a tax lien against the petitioner's land irrespective of any act of said Reclamation District or of any call by the County Treasurer, and said interest remains a tax lien upon the whole of petitioner said Conaway Ranch until paid.

6. Between 1925 and 1934 two of petitioner's predecessors in interest, to wit: A. Otis Birch and wife, acquired the title to the whole of the said Conaway Ranch and they also acquired all of the other

parcels of land comprising said district, except one small parcel, and caused such additional parcels so acquired to be and become a part of said Conaway Ranch; that between said dates said Birch and wife also acquired the ownership of a large majority of said bonds; that ever since 1934 except for said one parcel of land, and except for said property of said district, said Conaway Ranch has comprised the entire area of said district.

7. With respect to their income tax returns for each year between 1925 and 1934 said Birch and wife adopted the practice of deducting, and they did deduct, said item of \$120,000.00 as taxes, the same representing an amount sufficient to pay the total annual interest accruing upon said \$2,000,000.00 of bonds; also in said income tax returns for each of said years said Birch and wife did not account for or include as part of their gross income, any part of the interest received by them from any of said bonds upon the theory that such income was exempt from taxation under the laws of the State of California.

8. The Commissioner questioned each of said deductions for each of said years and said failure to include said income from said bonds, and in each instance, after investigation and consideration the Commissioner approved each of said deductions and said failure to include said income.

9. Ever since the said development of said district said Conaway Ranch has been operated as a farm in the raising of rice and sheep and other



farm products. Such operations require current financing in a sum substantially in excess of \$100,000.00 per year. After the commencement of the depression in 1929, A. Otis Birch and wife found it inconvenient to advance such current financing and they found it necessary and desirable to borrow money for such purpose. On attempting so to do, they found it then was the policy of all financial institutions not to loan such sums of money to individual persons and that it was impossible for them to borrow any substantial sum from such institutions, or at all, unless they should place a substantial part of their property in a corporate form of ownership.

10. Solely for the purpose of obtaining said current financing, and other financing, and for the purpose of enjoying the legitimate advantages of a corporate form of organization, said Birch and wife caused the petitioner herein to be incorporated on the 15th day of October, 1934, in the State of Nevada. On the same date and for the same reasons and as part of a convenient corporate set-up for the proper segregation of their properties, they also caused to be incorporated the Birch Securities Company, a corporation of the State of Nevada, and the Birch Holding Company, a corporation of the State of Delaware. Said Birch and wife thereupon transferred all of the aforesaid bonds owned by them to said Birch Securities Company and the whole of said Conaway Ranch, together with a portion of all other properties owned by them, to the petitioner herein. The petitioner and said Birch Securities



Company thereupon issued all of their respective authorized capital stock and transferred the same to the Birch Holding Company and said Birch Holding Company thereupon issued all of its capital stock and transferred 49% thereof to A. Otis Birch and 51% thereof to M. Estelle C. Birch, his wife, each of which persons owned all of said capital stock during the fiscal years involved herein.

11. The organization of all of said companies was made in good faith and was bona fide in every respect and said organization was not made with a view to affecting in any manner the obligation of said Birch and wife, or of any of said companies, to pay taxes of any kind or character, nor was it made for the purpose of enabling petitioner to take the deductions involved herein for taxes paid to said reclamation district, since the said Birch and wife for approximately eight years prior to the organization of said companies had been after full consideration by the Commissioner, as aforesaid, permitted to take said deductions from their income tax returns for each of said years.

12. Since its incorporation the petitioner has borrowed various sums of money from various banks and other financial institutions to the extent of substantially in excess of \$100,000.00 a year. The petitioner has ever since its organization engaged in the business of operating said ranch and of developing oil wells and other enterprises as a separate legal entity separate and apart from the activities and obligations of said Birch and wife and of said

other companies. Ever since its organization petitioner has had its separate creditors, separate and apart from said Birch and wife and said other companies, and said financial institutions and various other creditors have extended credit to the petitioner in reliance upon the fact that the petitioner is a separate corporate entity which is responsible for the payment of no obligations, including taxes, other than its own.

13. Petitioner is in fact a separate legal and corporate entity and it is not in any respect the alter ego of said Birch and wife or of said other corporations, or any of them, or of any other person or corporation, and its organization, and the aforesaid set-up, are legitimate and bona fide in every respect.

14. On October 15, 1934, the ownership of said bond issue was as follows:

Republic Life Insurance Company	\$ 86,000.00
Lula M. Minter	10,000.00
The Hopkins	309,000.00
A. Otis Birch and wife	1,595,000.00
	<hr/>
Total	\$2,000,000.00

15. That during 1941 and 1942 the ownership of said bonds was as aforesaid except that the Birch Securities Company on October 15, 1934, acquired the aforesaid bonds owned by A. Otis Birch and wife, of the said face value of \$1,595,000.00, and except that in 1940 this petitioner acquired said bonds owned by said Republic Life Insurance Company

of the face value of \$86,000.00; that except as aforesaid, this petitioner has not owned, and does not now own, any of said bonds.

16. On October 6, 1934, an election was duly held in said Reclamation District No. 2035 for the refunding of all said bonds, pursuant to the provisions of said Section 3480. At said election the issuance of 2,000 new bonds in the place of said old bonds was duly authorized. Said new bonds mature as stated in said Notice of Election and they are in like number and amount as said old bonds and they likewise bear interest at 6% to the end that such new bonds when issued take the place of said old bonds and to the end that interest upon the entire principal of said bond issue is continuous and a first and prior lien against all of the lands of the said district until said bonds are paid.

17. On or about 1942 said new bond issue was issued in the place of said old bonds. Pursuant to the provisions of said Section 3480 the said lands are subject to a lien of continuously accumulating interest at said rate of 6%, whether said interest accrues from said old bonds or said new bonds, and until said sum of \$2,000,000.00 is paid that all of said bonds are outstanding and unpaid.

18. Since 1925 the petitioner and its said predecessors in interest, in exchange for the use of said property of said district, including said warehouses, has paid all expenses for the operation of said district, so that the only expense which said district has and for which it need raise any taxes is the pay-

ment of said interest on said bonds in the sum of \$120,000.00 per year. By reason of these facts the amount of said Reclamation District tax against petitioner's land is exactly said sum of \$120,000.00 a year, which sum accrues solely by reason of the existence of said bonds and irrespective of the occurrence of any other event.

19. That at all times since its said organization petitioner has paid in cash to the County Treasurer of said Yolo County, or to the bondholders of said bond issue in exchange for an equivalent amount of interest coupons of said bonds, an amount of money or interest coupons sufficient to pay the taxes to meet the interest upon all of said bonds promptly as such interest became due, except that from 1936, up to and including the year 1940, this petitioner did not pay the amount of money necessary to meet the interest coupons as the same accrued upon the aforesaid bonds owned and held by said Birch Securities Company; that petitioner did not make said payments for the reason, among others, that in 1937 the Birch Securities Company became, and ever since has been, suspended by the Franchise Tax Commissioner of the State of California for alleged non-payment of certain California State Franchise taxes; that under the laws of the State of California, the said Birch Securities Company, during the existence of said suspension until 1941, was prohibited from delivering any of the interest coupons of said bonds owned by it, or from accepting any money therefor under penalty of a criminal prosecu-



tion, a severe fine, and possible imprisonment of its officers; that on June 9, 1941, said Birch Securities Company, through its president, A. Otis Birch, in an action entitled, A. Otis Birch vs. Charles J. McColgan, as Franchise Tax Commissioner of the State of California, the same being cause No. 1430B of the District Court of the United States for the Southern District of California, received an opinion from said court, sitting as a three-judge statutory court, to the effect that said suspension of Birch Securities Company was wrongful and void (39 Fed. Supp. 358); that thereafter a permanent injunction was issued by said three-judge statutory court prohibiting said Franchise Tax Commissioner from maintaining said suspension; that thereafter other obstacles which had prevented this petitioner from obtaining said coupons from said Birch Securities Company also became removed, and thereafter, to wit: commencing prior to October 1, 1941, and including the whole of the said fiscal years involved herein, this petitioner commenced to pay money sufficient to meet the interest on all of said bonds, including the said bonds of the said Birch Securities Company, that in every instance where this petitioner has paid money directly to said bondholders in exchange for interest coupons of said bonds, this petitioner has deposited said interest coupons with the County Treasurer of said county as the equivalent of money for the payment of said taxes; that the laws of the State of California permit and expressly provide that the taxes of a reclamation district may be paid in such manner.



20. Upon its books of account, petitioner included, for its fiscal year ending September 30, 1941, items of interest payable and paid on said bonds as taxes to said district in the sum of \$120,000.00. In its income tax return for said year, petitioner deducted said sum of \$120,000.00 as taxes accrued. Said deduction is a proper item of deduction for said purpose. Notwithstanding the facts aforesaid, the Commissioner erroneously disallowed said item in said Notice of Deficiency and Statement.

(e)1. Petitioner hereby incorporates paragraphs (d)1 to (d)20 hereof as part of this paragraph.

2. Upon its books of account, petitioner included for the fiscal year ending September 30, 1942, items of interest payable and paid on said bonds as taxes to said district in the sum of \$120,000.00. In its income tax return for said year, petitioner deducted said sum of \$120,000.00 as taxes accrued. Said deduction is a proper item of deduction for said purpose. Notwithstanding the facts aforesaid, the Commissioner erroneously disallowed said item in said Notice of Deficiency and Statement.

(f)1. Petitioner hereby incorporates paragraphs (d)1 to (d)20 hereof as part of this paragraph.

2. That in its income tax returns for the years ending September 30, 1941 and 1942, the petitioner deducted operating losses in the sums of \$184,085.69 and \$143,714.15, respectively, as shown by the Commissioner's said Notice of Deficiency and Statement; that said operating losses, and each and every

item thereof, were actual operating losses and proper items of deduction; that notwithstanding the facts aforesaid the Commissioner disallowed all of said operating losses upon the erroneous theory that petitioner's net income is determined upon the cash receipts and disbursements basis when in fact said net income should have been and is determined upon said accrual basis.

(g)1. Petitioner hereby incorporates paragraphs (d)1 and (d)20 hereof as part of this paragraph.

2. That by reason of the facts aforesaid, in its said income tax returns for the years ending September 30, 1941 and 1942, the petitioner made no declared value of excess profit tax assessed; that notwithstanding the facts aforesaid the Commissioner in said Notice of Deficiency and Statement erroneously assessed against this petitioner a deficiency of declared value excess profit taxes in the sums of \$4,565.41 and \$1,687.10, respectively, upon the erroneous theory that petitioner's net income is determined upon the cash receipts and disbursements basis when in fact said net income should have been and is determined upon said accrual basis.

(h) That during petitioners fiscal year ending September 30, 1943, petitioner suffered a loss by reason of non-payment of a loan made by it to the Birch-Smith Storage Company, a California corporation, operated and owned independently of said A. Otis Birch and wife, in the sum of \$52,031.26; that during said year petitioner also suffered a loss

of a loan made to one Edna Tiller in the sum of \$200.00; that during said year petitioner also suffered a loss by reason of an unpaid loan made to Mrs. A. E. Dye; that in its income tax return for said year, petitioner listed and deducted said items of loss in the total sum of \$52,481.26; that should this court deny any part of this petitioner's petition herein, this petitioner desires to carry back to its fiscal years ending September 30, 1941 and 1942, as much of said sum of \$52,481.26, up to \$12,000.00 thereof, as may be necessary to offset any part of the said tax deficiencies involved herein.

(i) That during petitioner's fiscal year ending September 30, 1944, petitioner suffered a loss in the sum of \$73,556.88 by reason of the drilling and abandonment of an oil well known as the Stovall-Wilcoxsen well, and the leasehold interest in connection therewith; that in the same year this petitioner suffered losses from sales of property other than capital assets as follows:

A 338-acre farm situated in Stanislaus

County, California .....	\$36,417.50
Lots 61, 112, 141, Tract 993.....	1,160.00
Lots 32, 36, 60, 91, Tract 993.....	1,520.00
Lots 87, 62, 189, 90, 108, Tract 993.....	1,730.00
Lot 201, Tract 993.....	1,200.00
Store Building, 320 Venice Blvd., Los Angeles .....	5,500.00

that in its income tax return for said year petitioner listed and deducted all of the aforesaid items of loss in the total sum of \$121,084.38: that should this

court deny any part of this petitioner's petition herein this petitioner desires to carry back to its fiscal year ending September 30, 1942, as much of said losses in the said sum of \$121,084.38, up to \$25,000.00 thereof, as may be necessary to offset any part of the said tax deficiencies involved herein.

Wherefore, petitioner prays that this court hear this proceeding and that the petitioner be granted relief as follows:

(a) That this court adjudge and declare that this petitioner's net income, and its system of accounting, for said fiscal years ending September 30, 1941 and 1942, and for all years, has been and is determined upon an accrual basis.

(b) That this court adjudge and declare that this petitioner's net income, and its system of accounting relating to said Conaway Ranch for each of said years, and for all years, is determined upon an accrual basis.

(c) That this court adjudge and declare that this petitioner's net income, and its system of accounting, relating to said Etiwanda Citrus Ranch, for each of said years, and for all years, is determined upon an accrual basis.

(d) That this court determine that the petitioner is entitled to a deduction in the full sum of \$120,000.00, accrued as taxes for payment of interest upon bonds of Reclamation District 2035 of the State of California for the fiscal year ending September 30, 1941.

(e) That this court determine that the petitioner



is entitled to a deduction in the full sum of \$120,000.00, accrued as taxes for payment of interest upon bonds of Reclamation District 2035 of the State of California for the fiscal year ending September 30, 1942.

(f) That this court determine that this petitioner is entitled to deduct the operating losses as deducted by it in its income tax returns for the said taxable years ending September 30, 1941 and 1942, and as disallowed by the Commissioner in said Notice of Deficiency and Statement.

(g) That this court determine that this petitioner's failure to include in its said income tax returns for each of said years any declared value excess profits is proper, and that the Commissioner's assessed deficiencies therefor, are erroneous and improper.

(h) That should this court deny any part of this petitioner's petition herein that petitioner be adjudged entitled to carry back to its fiscal years ending September 30, 1941 and 1942, as much of said sum of \$52,481.26, up to \$12,000.00 thereof, as may be necessary to offset any part of the said tax deficiencies involved herein.

(i) That should this court deny any part of this petitioner's petition herein that petitioner be adjudged entitled to carry back to its fiscal year ending September 30, 1942, as much of said losses in the said sum of \$121,084.38, up to \$25,000.00 thereof, as may be necessary to offset any part of the said deficiencies involved herein.

(j) That this court disallow and redetermine all



of the said deficiencies as determined by the Commissioner in said Notice of Deficiency and Statement.

GEORGE ACRET,

/s/ GEORGE ACRET,

Attorney for Petitioner.

State of California,

County of Los Angeles—ss.

R. R. Landrum, being duly sworn, says that he is the Secretary of the petitioner and that he is duly authorized to verify the foregoing petition in behalf of the petitioner; that he has read the foregoing petition and is familiar with the statements contained therein and that all of the statements contained therein are true except those stated to be upon information and belief, and all of such statements he believes to be true.

R. R. LANDRUM,

/s/ R. R. LANDRUM.

Subscribed and sworn to before me this 20th day of July, 1945.

[Seal] /s/ WILLIAM R. LAW,

Notary Public in and for the County of Los Angeles, State of California.

Received and Filed T.C.U.S., July 25, 1945.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the amended petition of the above-named taxpayer, admits and denies as follows:

I and II. Admits the allegations contained in paragraphs I and II of the amended petition.

III. Admits that the taxes in controversy are income and declared value excess-profits taxes for the fiscal years ending September 30, 1941, and September 30, 1942, as alleged in paragraph III of the amended petition and denies the remaining allegations contained in said paragraph.

IV (a) to (g), inclusive. Denies the allegations of error contained in subparagraphs (a) to (g), inclusive, of paragraph IV of the amended petition.

V (a), (b) and (c). Denies the allegations contained in subparagraphs (a), (b), and (c) of paragraph V of the amended petition.

(d) 1 to (d) 19, inclusive. Denies the allegations contained in subparagraphs (d) 1 to (d) 19, inclusive, of paragraph V of the amended petition.

(d) 20. Admits that in its income tax return for its fiscal year ending September 30, 1941, petitioner deducted said sum of \$120,000.00 as taxes accrued as alleged in subparagraph (d) 20 of paragraph V of

the amended petition and denies the remaining allegations contained in said subparagraph.

(e) 1. Denies the allegations contained in subparagraph (e) 1 of paragraph V of the amended petition.

(e) 2. Admits that in its income tax return for the fiscal year ending September 30, 1942, petitioner deducted said sum of \$120,000.00 as taxes accrued as alleged in subparagraph (e) 2 of paragraph V of the amended petition and denies the remaining allegations contained in said subparagraph.

(f) 1 and (f) 2. Denies the allegations contained in subparagraphs (f) 1 and (f) 2 of paragraph V of the amended petition.

(g) 1 and (g) 2. Denies the allegations contained in subparagraphs (g) 1 and (g) 2 of paragraph V of the amended petition.

(h) and (i). Denies the allegations contained in subparagraphs (h) and (i) of paragraph V of the amended petition.

VI. Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL,  
Chief Counsel, Bureau of  
Internal Revenue.

ECC

Of Counsel:

B. H. NEBLETT,  
Division Counsel.

E. C. CROUTER,

H. A. MELVILLE,  
Special Attorneys,  
Bureau of Internal Revenue.

Received and Filed T. C. U. S. August 29, 1945.

The Tax Court of the United States

Docket No. 8720

BIRCH RANCH &amp; OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

June 30, 1947—10:10 A.M.

(Met pursuant to notice.)

Before: Honorable John W. Kern,  
Judge.

Appearances:

GEORGE H. ACRET,

650 South Grand Avenue,  
Los Angeles, California,

Appearing for the Petitioner.

EARL C. CROUTER,

(Honorable J. P. Wenchel, Chief Counsel,  
Bureau of Internal Revenue),

Appearing for the Respondent.

## PROCEEDINGS

The Court: I will call Docket 8720.

Mr. Acret: Ready for the Petitioner. George  
Acret.



Mr. Crouter: Respondent is ready, if the Court please. Earl C. Crouter for the Respondent.

Mr. Acret: I have a plan of procedure here, your Honor, which I think should shorten this matter down to less than 10 minutes, plus the time necessary to make an opening statement. I think an opening statement acquainting your Honor with the history of this matter and the facts, as found in a form of proceeding, will shorten this down.

I presume your Honor would like to save the time at this time if it is possible to do.

The Court: Your supposition is correct. May I have a statement as to the issues?

Mr. Acret: Yes, your Honor. The issues concern a deficiency—by the way, may I ask if your Honor has read the amended petition? We had one printed that contains a complete statement of the ultimate facts and the facts are complicated and they're in considerable detail. I think it is a 21-page printed petition.

The Court: Yes, I see it.

Mr. Acret: Your Honor has not had time to read it?

The Court: I have not read it. [3\*]

## OPENING STATEMENT ON BEHALF OF THE PETITIONER

By Mr. Acret:

The deficiency concerns the years ending September 30, 1941, and September 30, 1942. The Petitioner,

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\* Page numbering stamped at top of page of original Reporter's Transcript.

the corporation has its system of accounting on a basis of fiscal year ending September 30th. The main point that has been previously in litigation, concerning the same right to a deduction, which is involved here and which is a deduction made by the Petitioner of \$120,000.00, paid by it to meet taxes which accrue as a matter of law, to meet 6 per cent interest on \$2,000,000.00 bond issue of reclamation bonds which are against Petitioner's lands.

The facts and the history and the findings of fact in a former case concerning the Petitioner's right to make this same deduction for the year, I think it was 1937, 1939, are contained in Docket No. 109993, in which Judge Turner made findings of fact under date of April 20, 1944.

The Court: That was a memorandum of finding of facts.

Mr. Acet: That was a memorandum of finding, yes, sir, your Honor, findings in the case.

The material facts which ought to be stated to the Court at this time are as follows: As will appear the laws of the State of California commencing way back in 1880 held out to persons undertaking to reclaim waste lands in [4] California the inducement that there might be a bond issue on the money spent, a reclamation district formed and a bond issue covering the money spent in improving the reclamation district, and that the interest on such bonds would be exempt interest.

Commencing about 1918, in order to take advantage of this inducement that was held out A. Otis Birch and a group associated with him acquired

about 20,000 acres of these waste lands in the Sacramento Valley in Yolo County, about 14 miles out of Sacramento.

They proposed a plan for improvement of the district and petitioned for the formation of a district within a certain area under the law relating to reclamation districts in California. They proposed that some 18 parcels of land, in addition to their own parcel, including about 20,000 acres, making a total of about 22,000 acres be included in the district.

Some of the parcels were rejected at a vote held for the purpose of forming the district, or rather by the board of supervisors of the county, as provided by law, and other additional parcels were brought in. The district was formed in 1918, including approximately 13 separate parcels of land, of which the parcel involved herein was one.

Mr. A. Otis Birch and his associates undertook to make improvements of the district in accordance with the [5] plan which was adopted and approved by the supervisors of the district, and approved by the State Engineer for the reclamation district.

Whatever money Mr. Birch and his associates spent—the exact amount is immaterial—it is sufficient they built some 45 miles of road and 47 miles of canals, for which the members of the district approved their right to receive a warrant in the sum of \$2,000,000.00. That warrant being unpaid, that is, still in 1918, in accordance with the forms of law, a \$2,000,000.00 bond issue was duly voted to pay this \$2,000,000.00 warrant and the bonds in exchange for the warrant were turned over to Birch and his as-

sociates. During this period when they were turning in the warrants and completing the work Mr. Birch and his associates acquired all of the parcels of land in the district. Subsequently Mr. Birch and his wife acquired, from time to time, additional bonds and they bought out the interest of Mr. Birch's associates in the land itself; the Conaway ranch then consisting of 22,000 acres.

On each year after the bonds became due, which according to my recollection, after they became in force, was some years after 1918; and in any event before 1925 Mr. Birch and wife themselves paid into the district the sum of \$120,000.00, to enable the district to meet the interest on these bonds, and which were then owned by themselves. [6]

Under the statute these bonds, including their interest at 6 per cent a year, and which becomes due on July 1st and January 1st, \$60,000.00 each paying date, these bonds by statute become a lien on the land until paid. That is, including interest and principal.

It happens there was—I mention this—a refunding of these bonds, authorized in 1935. The bonds run 10 years, but due to the fact that some of Mr. Birch's associates still owned the bonds and they wouldn't turn them in, the actual refunding could never be accomplished and it never was accomplished until after the tax, the years involved in this tax assessment. As a matter of fact, I understand it wasn't accomplished until 1946, at which time there was a third bond issue. I will state to your Honor at this time there is nothing involved here for the



future, because Mr. Birch and wife no longer own the bonds, and they no longer own the ranch; they sold the bonds.

This whole venture was very unfortunate and expensive in that the ranch never paid Mr. and Mrs. Birch any yield at all on the amount of their investment, which was in excess of \$2,000,000.00. In fact, there were continuous losses.

Mr. and Mrs. Birch deducted this \$120,000.00, which they paid to the County Treasurer to enable the district to meet this interest on these bonds each year, [7] in making tax returns, and as found by Judge Turner the Commissioner questioned the propriety of their doing this, and after an audit was made and an investigation made of the situation in each instance their right to make this deduction was approved by the Commissioner.

The facts would appear that when Mr. Birch took over the entire ranch of 22,000 acres he made a deal with the district and which, frankly, was with the board of directors of the district, persons, of course, elected by himself. They were, nevertheless, legitimate and actual directors and the district is independent, an independent state agency, created by statute.

Mr. Birch and wife deeded to the district land sufficient to enable the district to have its own roads and the right-of-way through all the ditches and two acres for a warehouse belonging to the district. They made a deal with the district whereby, if they maintained this land and these rights-of-way and the ditches, that they would have no expense from the



district, other than the expense to meet these bonds. So that the amount of the expense of the district and the amount of the district's tax was in the sum of \$120,000.00 a year, a fixed sum, irrespective of the occurrence of any other events. That accrued by statute and was an accumulating lien on Petitioner's land, and irrespective of whether or not the [8] County Treasurer made any call or any assessment on these bonds. The interest accumulated as a lien just by statute.

In 1934 Mr. Birch was then nearing 70 years of age and the banks required of him, before he could have any further financing, to put his property in a corporate form. At that time the Birch Ranch & Oil Company, together with other corporations which are immaterial here, for reasons that should appear from the facts, were formed.

Judge Turner found that the corporation was formed to enable the Conaway Ranch to get, or Mr. Birch to get bank credit, a legitimate reason for forming the corporation. The corporation, it would appear, was not formed for any purpose to avoid taxes, because Mr. Birch was being permitted to make the deduction of \$120,000.00 a year, when he owned both the land and the bonds, and just because he formed the corporation seems to have clouded the issues here. It should increase the right to deduct and not decrease it. In any event, the right to make the deduction existed all the time.

After its formation as a corporation in 1934 the corporation purported to place its system of accounting on an accruable basis. It had varied operations,

including the operation of certain oil wells, several ranches down here in Southern California and the Conaway Ranch in Yolo County. [9]

Mr. and Mrs. Birch, in forming the corporation, did not transfer all of their property to the corporation but held out in their own individual names property of the value of about \$600,000.00. So it would seem there could be no question of alter ego.

The corporation in 1934, it being in the midst of the depression, was not able to make the payments to the County Treasurer of \$120,000.00, and it accrued that amount as taxes on its books. As a matter of fact, it was not able to make any substantial payment to the County Treasurer at the time of the trial, up to and including the time of the trial before Judge Turner, and it did not make substantial payments until commencing about 1944 when the financial situation was different than it had been at the time the corporation was first formed.

The Commissioner assessed a deficiency for 1937 and 1939, I think the years were, which was the reason of the Petitioner's deduction of that \$120,000.00 as taxes on an accruable basis; and that is the Petitioner's right to do. That is the matter which was heard before Judge Turner.

Judge Turner made a complete findings of fact which are very efficient and able, and which is the correct statement of the facts, I think, in every respect. This matter was heard for about four days. The only question that we think went off was that Judge Turner concluded [10] from the facts that the amount paid by the taxpayer to meet the interest on

the bonds was the payment of interest, and stated that is the only misstatement of facts, that the taxpayer accrued the payment of interest paid. It was accrued as taxes paid and it was deducted in its income tax return as taxes paid.

It would appear that is the proper way to do it, by virtue of the Little case, which involved a similar situation, in Idaho, concerning irrigation bonds, in which this Court pointed out that the land owner and the owner of the bonds, and the district were three different entities, and what the landowner paid was the taxes to allow the district to meet the interest on the bonds. It would appear that, to be correct, that was a situation where the Commissioner so concerned—the landowner deducted it as interest. The Court held it couldn't be deducted as interest, but should be deducted as taxes.

The Court: What is the difference, Mr. Acret?

Mr. Acret: It will make no difference here, except it did with Judge Turner because—I can't quote offhand the section of the code, but the amount that we paid wasn't within the period that the taxable year, within two months thereof; that made the difference in that case.

The Court: Yes. [11]

Mr. Acret: It doesn't make any difference here, for reasons which I am about to state.

Your Honor may be wondering why we started this action, when this proceeding—on the basis of my statement concerning Judge Turner's findings of fact. Judge Turner's findings of fact, he allowed the interest which the Petitioner paid to the district to

meet the interest for certain bonds owned by third parties. The Commissioner hadn't allowed those, and Judge Turner made findings of fact, ultimate facts, from which it appears it is a necessary conclusion of law the bonds are bona fide and the organization of the district is bona fide and the organization of the corporation is bona fide, and he allowed the deductions which the corporation actually paid for the year in question, and disallowed other deductions because he held as to the ranch books we were not on an accruable basis and on a cash basis.

Now, here comes the crux of the situation with reference to this case. We appealed from that decision, or we petitioned for a right of certiorari to the Supreme Court, questioning the finding that we were not on an accruable basis. The Supreme Court denied our petition and it is my belief that the Government in this former case is *res judicata*. It is also my belief that Judge Turner's findings of fact concerning almost identical [12] transactions and identical deductions are the facts of the case, as far as, even as this case is concerned.

The Court: Who was the taxpayer in that case?

Mr. Acret: The Birch Ranch & Oil Company.

The Court: Oh.

Mr. Acret: What has happened since, your Honor, since we filed the petition, we were not only denied the petition for a writ of certiorari but in auditing the Petitioner's books for 1944 the Commissioner of Internal Revenue has fixed and determined a per cent to that, the fact that Petitioner is on a cash basis. One of the things we wanted to



know is whether we are on an accruable basis or whether we are on a cash basis. That seems to have been fixed by the letter we have from the Internal Revenue Agent in Charge for January, dated January 23, 1947, concerning the audit of Petitioner's fiscal year ending 1940.

Now, that removes one of our biggest difficulties. We are satisfied to be on a cash basis. In this letter, in connection with the audit for 1944, figuring on a cash basis, the Internal Revenue Agent in Charge states as follows: "For the history of taxpayer see prior agent's reports and U. S. Tax Court's findings of fact in opinion re Birch Ranch & Oil Company v. Commissioner, Docket No. 109993." [13]

That is the one I have been referring to. In the report for the year 1944 Petitioner deducted, showed a loss of \$84,179.37, and here is what the letter states:

"The additional net loss, as shown in this report, is brought about by the allowance in full of amounts paid by the taxpayer in this fiscal year for assessment taxes on Reclamation District 2035." That is \$120,000.00 to enable the district to meet the interest on these bonds.

"A part of the amount paid in this year covers amounts accrued on the corporation's books in prior years, and disallowed in the prior agent's reports as deductions, since the corporation was on a cash basis. For a breakdown of these amounts see Schedule 1-A of this report.

"The findings as shown in this report are discussed with Mr. Robert K. Landrum, Secretary of



the taxpayer corporation, who agreed to all the proposed adjustments shown in this report.”

Now, we have Schedule 1-A, “Adjustments to Net Income, Net Income as disposed by return \$84,-179.37,” which means a loss of that amount. And then it says, “as corrected \$186,899.37.”

The Court: May I interrupt, Mr. Acret? Do I understand you therefore are abandoning the issues as set out as IV (c) in your amended petition on page 3, in which you allege the Commissioner erred in holding that the income—[14] no, excuse me. It is (b) on page 3; IV (b) on page 3.

Mr. Acret: Yes.

The Court: “In disregarding the inventories covering Petitioner’s Conaway Ranch for each of said fiscal years upon the theory that the net income of said ranch is determined upon the cash receipts and disbursements basis, when, in fact, the net income of said ranch, and Petitioner’s entire system of accounting at all times has been and is determined upon its accrual basis.”

I understand now that you abandon that.

Mr. Acret: Yes, I am doing that because I believe we are forced to, and besides that I believe that on the basis of the Commissioner’s findings in that letter, and so forth, if they are satisfied with us being on a cash basis we are, too.

Your Honor, on page 21 of the petition, if you will notice, we ask that in the event any of these errors assessed be disallowed, that we be allowed to carry back the losses from 1944. I will state to your Honor, and I don’t wish to waste the Court’s time

with things we can't do, we can't do anything with reference to the assessment relating to 1941. We only have a right to relief as to 1942, which is the Paragraph (i). The assessment for 1942 is some twelve or thirteen thousand dollars, and we have enough loss in 1944, as approved by the Commissioner [15] in this letter, with all possible deductions under the rules applicable under Section 122 to allow us four or five times the amount of loss necessary to offset this assessment, deficiency assessment for the year ending 1942.

Now, our return for 1944 has never been held in question. There is no deficiency assessment concerning it. All there is, rather than it being held in question, is an approval and increase of that loss we deducted of eighty-four thousand to a net adjustment of the loss to \$102,720.00.

Now, here is what I propose: That the Petitioner be allowed to carry back as much of that loss as may be necessary to meet the deficiency assessment for the year 1942. We abandon any claim on the 1941 because we figure that under our position we can't get anywhere; can't carry back more than two years. That is all that we can carry back to.

Now, I appreciate that the Commissioner might subsequently make a deficiency assessment for 1944, but there is no issue on that yet and this Court could make an order of our right to carry that back, subject to any subsequent deficiency assessments for 1944, that might be assessed. There would be no injustice that way.

The Court: Is there any question at the present time concerning the allowable loss in 1944?

Mr. Acret: I think counsel questions it, and [16] I am submitting the suggestion to counsel that if it develops that the agent in charge's report here, they wish to amend it, and I presume they would have a right to at any time, then this carry-back would be subject to the same adjustment if there was any deficiency. There is no issue before the Court as to the propriety of that loss we have on our 1944 return. If an issue should subsequently arise we would be willing to stipulate this carry-back could—

The Court: Now, do I understand, Mr. Acret, your position is—I state this with a question mark at the end of it—that there is a deficiency in tax of the Petitioner for the year 1941, as determined by the Respondent, in the sum of \$7,833.44, and that there is a deficiency in tax of the Petitioner for the year 1942, ending September 30, 1942, as determined by the Respondent in the sum of \$11,915.67, but as to the tax liability of the Petitioner for the year ending September 30, 1942, the Petitioner is entitled to carry back a loss for 1944; and that therefore the deficiency in the amount of \$11,915.67 does not exist or would not exist or will not exist if the Petitioner is entitled, or is permitted to carry back its loss for 1944?

Mr. Acret: That is an accurate and correct statement of our position, your Honor. Except your Honor did not include the deficiency assessment for the excess profits tax for 1942. [17]

The Court: Yes.

Mr. Acret: That is \$1687.10.

The Court: There is no question now raised as to the deficiencies determined by the Respondent in income tax and declared value excess profits tax for the year ending September 30, 1941, in the respective amounts of \$7,833.44 and \$4,565.41.

Mr. Acret: That is correct, your Honor.

The Court: There is no question as to the amounts of the deficiencies determined for the year ending September 30, 1942, and income tax and declared value excess profits tax, but the Petitioner is now claiming in this proceeding the right to carry back to that year the losses shown in its 1944 return.

Mr. Acret: That is correct, your Honor. And your Honor, I see that the reason we can't do that, if we were on a cash basis, is that the Petitioner did not pay that tax and was unable to pay any taxes until later; and as found and determined by the Internal Revenue Agent in Charge it did pay the amounts as shown here during the year 1944 and paid those in cash. That is the reason the Petitioner's deduction is proper for 1944, if it is on a cash basis.

The Court: Mr. Crouter. [18]

## OPENING STATEMENT ON BEHALF OF THE RESPONDENT

By Mr. Crouter:

If your Honor please, I do wish to make an opening statement on behalf of the Respondent and at the risk of it being a little bit lengthy I would



like to go back into the prior case and try to explain the situation in which we find ourselves in this proceeding.

I gather that your Honor appreciates the situation regarding 1941, and I will come to that. I think that will expedite matters here. Now, on the pleadings as this case stands, if the Court please, you have observed that the proceedings here relates to fiscal years 1941 and 1942. We have deficiency income taxes aggregating \$19,749.11 for both years, and in deficiency and declared value excess profits taxes aggregating \$6,252.51. That is the total for both years.

Now, it might be helpful to the Court for me to make this statement, that I believe you would appreciate, and you might even have the question in your own mind, "Why are we here if we had this prior case before Judge Turner?" It is true there was this prior proceeding of Birch Ranch & Oil Company, this same Petitioner. That case was submitted to the Court out here at Los Angeles on April 5 and 6, 1943.

The findings of facts and opinion came down on the date counsel stated, which was April 20, 1944; approximately a year later.

The case was affirmed on appeal before the Ninth Circuit, the citation being 152 Fed. (2d), 874, and as counsel has stated certiorari was denied by the Supreme Court.

Now in the subject proceeding relative to the years 1941 and 1942, we have similar assignments of error with respect to the accounting basis of



the Petitioner. As counsel has stated, if they were properly on the accruable basis and they were entitled to accrued liability, even though not paid, there might be basis for contending for deductions on that basis. But as I see this situation the prior decision holding that Petitioner was on the cash basis for the prior fiscal years, 1937 and 1939, really in effect controls the accounting question in the subject years, because, as I understand it, about the same system of accounting came through.

So while there is no issue here of *res judicata* raised by either side and strictly that doctrine might not apply, because we have different years, and the facts conceivably could be different. I believe it is the prior decision that compels the results that the Petitioner here for the taxable years, 1941 and 1942, is still on the cash basis.

Now, I believe there will be no question here but Petitioner did not pay any amount whatever as tax or as interest for a period of about 10 years, between 1933 and 1943. That, of course, includes these taxable years.

Now, as I read the Petitioner's pleadings in this case, all assignment of error relating to both years relate to the accounting basis, and this question of taking deductions for taxes or interest accrued on their records.

The right is claimed because of the accruable, and the petition there, I believe, was filed before the decision in the prior case. Now, there was an amended petition here, July 25, 1945. However, that case was still in the courts.

Mr. Acet: I think that was filed within 30 days, that amended petition.

Mr. Crouter: Yes. But the prior case was still on appeal at that time.

Mr. Acet: Yes.

The Court: That is right.

Mr. Crouter: That is the similar position they had in the prior case. I might also state, for the Court's information, and with your permission, I would like to read two sentences from Judge Turner's opinion in the prior case, to show the questions we raise now were not decided there. This is from page 21 of the mimeographed opinion:

"In view of the conclusions reached and the [21] reason therefor, we find it unnecessary to rule on the Petitioner's claim that the bonds of reclamation, District No. 2035, were at all valid and subsisting obligations, consisting of a lien or charge upon the property of the Petitioner so as to entitle it to deduct so much of the amounts paid thereunder as is allocated to interest.

"Neither do we find it necessary to rule on the contention of the Respondent that the owners of the bonds herein question were in reality the owners of the land against which the bonds were issued, and that the bonds do not therefore represent real and actual obligations outstanding."

Now, as your Honor has already perceived, those questions are inherent in the subject case in this respect:—and I believe at this time it would be appropriate, if the Court please, and I now make a motion with respect to the pending proceeding,

Docket No. 8720, and the fiscal year ended September 30, 1941—that the deficiencies in income tax and in declared value excess profits taxes, which are asserted in the deficiency notice, the amounts of which have been previously stated by the Petitioner counsel, be found by the Tax Court and they be sustained on the basis any assignments of error or fact alleged in the petition have now been conceded, abandoned or withdrawn, in effect, by the Petitioner, so that there is no issue or no necessity of going into that matter further. I would like to have that motion of record.

The Court: The Court will take it under advisement.

Mr. Crouter: Now, with respect to the fiscal year, 1942, the situation is very similar with one exception, if the Court please. As I read the petition there is no assignment of error whatever relating to 1942, and to any error of the Commissioner, except this accounting question and the question of accrual or cash basis. I believe that counsel for Petitioner has now conceded that for both years Petitioner is conceding to be on the cash basis, as previously held in the prior case. And since there is no error whatever relating to any action of the Commissioner with respect to 1942, I move that decision be entered in favor of the Respondent for the fiscal year 1942 for both the income tax and declared value excess profits tax deficiencies in the amounts asserted in the deficiency notices, which amounts were previously stated by the Court.

The Court: Motion taken under advisement.

Mr. Crouter: I might say in that connection, if the Court please, there is only one matter in the petition that I can see that conceivably refers to this 1944 carry back question. In the statement of facts, I believe I can [23] cite your Honor the exact place where that occurs.

Mr. Acret: Is it page 18, counsel?

Mr. Crouter: Yes. Thank you.

On pages 18 and 19 of the printed amended petition, subparagraph (i),—now, mind you, if the Court please, this is all a part of a statement of facts which is really repeated by reference starting at page 16, but it all refers back to the commencement of Petitioner's allegations of fact; that is V, page 4.

“The facts upon which the Petitioner relies as a basis of this proceeding are as follows:—”

Then we go down through considerable setup of facts for the first year and a repetition starting at page 16 for reference, then with new paragraphs, and the last one is subparagraph (i) of pages 18 and 19. That relates to an alleged net loss for 1944.

The same fiscal year ended September 30, 1944, which, under the two-year provision of Section 122, relating to carry-back, I assume Petitioner now desires to have carried back, and asserted for 1942.

Respondent on time and as soon as this petition was filed denied the allegations of fact, including subparagraph (i). I don't believe there is any question about that. That has been denied, since the Respondent's answer was filed on August 29,



1945. That remains denied, and that is still [24] Respondent's position.

Now, with respect to these other losses referred to in that subparagraph (i) at the top of page 19, Respondent does not contest other losses or deductions, except on account of this bond situation.

As I see this case, we still have undecided and pending for the Court's decision, if we have to go into that here, the question of whether Petitioner is entitled to deductions for this tax or interest. I think there is a very serious question whether that matter is properly before the Court. I believe that counsel has referred to that previously, in saying he appreciates there is no issue here regarding 1944.

Now, it is contended for administratively, and has been under consideration administratively, that is not final. It is not conceded that the Petitioner is entitled to those deductions, as counsel said, the statutes are still open. That is still a matter for the Bureau of Internal Revenue for the prior years, 1941 and 1942.

If the Court rules that is a pending issue in this case and is properly before this Court and this is the appropriate time and place to go into it, the Respondent is prepared to go through and litigate that question.

The Court: What question, Mr. Crouter?

Mr. Crouter: The question of the right to carry back an operating loss from 1944 to offset the deficiency for 1942. As I understand, that is counsel present position.

The Court: Turning to pages 18 and 19, does



Respondent deny—I know that Respondent has denied in the pleading—does Respondent now at this hearing contest and deny the fact that losses in the amounts stated were sustained by the Petitioner in its fiscal year ended 1944?

Mr. Crouter: Yes, we do, if the Court please.

The Court: Only \$121,084.38?

Mr. Crouter: There are different amounts, because of the accounting basis. The return for that year, as I understand, claimed a deduction for tax of \$123,666.17. On account of the reclamation bonds.

The Court: The losses itemized on pages 18 and 19, as I understand it, were not on account of taxes but were by reason of drilling and abandonment of an oil well as were other itemized losses appearing on 19.

Mr. Crouter: Yes.

The Court: Those are alleged in the amended petition, a total of \$121,084.38.

Mr. Crouter: I believe Petitioner's position is he still claims losses based on these taxes in addition to those items which are specifically enumerated. You see, he does have the total figure right at the last line on page 18, contending for a net loss of seventy-three thousand [26] plus. And that is arrived at through various other adjustments, but they include, it is my understanding they include an item based upon these alleged taxes.

The Court: Is that correct, Mr. Acet?

Mr. Acet: Yes, your Honor. Then when we were put on the cash basis the Internal Revenue

Agent in Charge—because we paid some two hundred twenty-one thousand in taxes that year in cash—he changed our net loss to \$120,000.00, I think it is, by that statement.

It is true this petition was made before we had to concede we were on a cash basis, and it changes the amount of our net loss to the basis stated in this letter. This letter concedes the payment of \$221,610.00 paid by certified check as taxes to the County Treasurer during the year 1944. That in itself is part of our return. We paid that amount or would be on a cash basis, on an accruable basis; we just deducted \$123,666.17. Now, that alone is sufficient to give us a carry-back.

The Court: Then the existence of a loss subject to carry-back depends upon this tax deduction allowed in this tax payment allowed in 1944, is that correct?

Mr. Acret: Yes, your Honor. We contend that in 1944, due to change in circumstances, there is no issue as to that, and if any issue subsequently arises we are willing to have this carry right to the carry-back [27] determined by the final determination of that question, when the issue of 1944 does arise.

Now, all we have is a statement of the Agent in Charge approving our payment of taxes in two hundred twenty-one thousand and our deduction of that. They themselves on their accounting rendered to us include that in the net loss they credit us with.

The Court: As I understand, now, Mr. Acret, all you want is an order now in this proceeding that you are entitled to a carry-back if, as and

when it is determined that there is a net loss, subject to a carry-back in 1944, is that right?

Mr. Acret: That would be the effect of it. That is on the theory your Honor has jurisdiction now to grant this right to carry back. If it weren't granted now we would lose all our right to relief.

The Court: And if it should develop there is no loss subject to carry-back, you would get no relief.

Mr. Acret: That is right. That would only be common justice, to have that provision.

The Court: How do you anticipate that question will be decided?

Mr. Acret: It will be decided if and when the Commissioner changes his mind as to this statement rendered and instead of rendering this statement approving the return [28] assesses a deficiency for 1944. That is all. Then there will be precise issues which we can then meet on the cash basis. As it is, when we started this we were all at sea. As Judge Turner said, he didn't decide whether they were on accrual basis or cash basis. He decided we were on a cash basis with reference to the Conaway Ranch.

The Court: I think we interrupted Mr. Crouter.

Mr. Crouter: I would like to say, about the question discussed with counsel, I don't think there is any misapprehension or misunderstanding regarding the position of the Respondent, as exercised by the Technical Staff here at Los Angeles as far as the Court observes, from the calendar, this case was on the prior calendar we had this spring. It was continued over from that calendar, particularly be-

cause of this net loss question, so both sides would have an opportunity to go over and consider it. I don't want the Petitioner to have any misunderstanding about the position of the Respondent on this question. It is my understanding the Bureau of Internal Revenue and the Commissioner do seriously question and are inclined to, and disallow this carry-back based on the bond question; and at the years 1941 and 1942, which are before the Court now. I know that some things are subject to administrative adjustment. After the decision, whether a net loss carry-back properly could be, even after the Court decided this [29] question on the issues presented, it might be subject to adjustment. I am not intimating and my own guess is the Commissioner would not allow any adjustment administratively, such as the Petitioner now claims, based on a net loss carry-back for 1944. This question has been up and discussed by the staff. Counsel has been informed long prior to today we do not concede that point and we do not concur in his position.

In other words, I think I should go further with my opening statement, as I previously planned to and tell the Court the basis and reason for that. Fundamentally it breaks down to two questions. I might, in the first place, say there is very serious question in Respondent's mind as to whether there was any real tax or any real interest paid here, for which a deduction should be allowed or recognized under the Internal Revenue Code. We have a very



unusual situation, in that it is a closely held corporation.

It is my understanding, although there might be some slight discrepancy, Mr. Birch and his wife owned entirely and they have for years owned entirely the Petitioner corporation. We have these bonds held by Mr. Birch. We have the land owned by the corporation. We have a situation here, if the Court please, where the Respondent contends there is no real liability for paying any amounts of interest or taxes, so that there is no real foundation for the [30] claiming of deductions.

Now, that breaks down into several points or facets, I might say. If we go into this question here I think it will be clear and no doubt whatever for this period of 10 years, from 1933 to 1943, no payments whatever were made, no demands made. That indicates somewhat the question whether there was any real legal liability. The story there is a rather long one and I will not try to cover all the facts in the opening statement.

On the question of liability there are a number of things I would like to mention, if the Court please. And I am referring now to the question of these deductions claimed for 1944; bring it right down to date. Respondent's position is there were no valid bonds outstanding in 1944 which required any payments of interest or taxes. And that there were no real lien on property which required the making of such payments. I might also state it is my view and I will attempt to show these payments were made——



The Court: May I interrupt again, Mr. Crouter? I am sorry to interrupt. I want to get these things straightened out. When you are speaking about the Respondent's position, you are speaking about the Respondent's position as you know it at this time, and not with reference to the Revenue Agent's report which is referred to by Mr. Acret?

Mr. Crouter: That is correct. [31]

The Court: And you are not referring to any formal determination of the tax liability of the Petitioner for the year 1944, as I understand, as there has been no determination of deficiency or final action taken by the Respondent with regard to that.

Mr. Crouter: That is correct, if the Court please.

The Court: You are speaking now of the Respondent's position as to this case.

Mr. Crouter: That is correct, and particularly in support of our denial of the allegations under the fact they are including in the allegations there was a net loss for 1944. That is, it is very meager and it is very thin. There is that allegation in the petition and that has been denied. I am arguing in support of all our grounds to support that denial.

As the second point on the question of liability, Respondent contends where we have a complete ownership of the individual and the corporation, the individual owning the bonds and the corporation owning the land, and that there is no real issuance of bond, that bonds are not held by a third party, an arm's length transaction, there again we have a sort of merger of the individual and his

corporation, so even if there were any liability at any time it would be merged. When that situation arose, as we may show in this case, there was an acquisition by Mr. Birch of all of the [32] bonds which were outstanding, even in addition to those which he did not acquire at their inception. I believe he and his wife held most of the bonds right from the beginning. They had contracts and arrangements and agreements whereby they would own and control this entire situation. I might clarify one part, if the Court please.

Mr. Acret: I was going to say, you won't have to show—I will concede all these facts. They are not in question.

Mr. Crouter: I would like to clarify one thing, if the Court please, and that is, this was not an active reclamation project instituted and carried out at the time the Petitioner was formed or at the time these bonds were issued. As I understand, the actual reclamation work forming the basis of all this was long before this reclamation district was organized and bonds issued to the tune of about \$2,000,000.00, and then on certain dates in 1944, four different dates on some subsequent dates, amounts were routed through the County Treasurer's office. He was an officer of some kind of the reclamation district, also.

I wish to get this picture across to the Court. On a certain date an amount usually close to \$60,000.00, sometimes a little less, sometimes a little more, would be paid into the County Treasurer's office. He would immediately draw a check payable to the

holder of the bond. So that we [33] do not have payments of taxes or payments for work undertaken in a real sense. We have an exchange of moneys through the County Treasurer's office, and that is the best that the Petitioner could show here with respect to payments of the so-called obligations. That runs right to the question, as the Court will perceive, of the relationship of Mr. Birch and his corporation. There is a question here, and I will confess it isn't clear in my mind, if the Court please, and I have not been able to see or examine the original evidence, as to what bonds, if any, were really outstanding during the 1944 period. The original issue was 1925, and it has been contended that there was a re-issue or a refunding operation, and then a second re-funding operation. I am not certain whether counsel contends they were bonds of the second re-funding operation or the third re-funding operation, which were outstanding, on which they claim they made payments in 1944. But even if bonds were drawn up and names put on them, and they were on the face of it issued, I don't believe they have any higher standing than the original.

I might say it really stems, as I see it, from the organization of the reclamation district and Mr. Birch was given a county warrant for \$2,000,000.00. He received this—Mr. Birch and others, I should say, Mr. Conaway, in particular—I believe it is his father-in-law—they [34] received this warrant that was not for cash put in. That was on account of reclamation done years before. That was the con-

sideration for it. That warrant was not left outstanding. The warrant was almost immediately cancelled of record and the warrant was exchanged, given back to the officials of the accounting and reclamation district, and the bonds were received in lieu of the warrant.

Now, as Respondent sees this, if the Court please, it is difficult and almost impossible for us to see that these bonds had any purpose whatever, affected anything at all except taxes. They did not affect actual operations. They did not affect any real excavation work or reclamation work. They did not create this system and situation whereby at first merely accruals were put on the record, deductions claimed for accruals. There was no money moving whatever at first. The returns were questioned and it was litigated and, as counsel stated, the decision of the Tax Court required actual payment. After that date we have the form of payment going through. Respondent contends the result is no different, in effect, as Mr. Birch is taking out of one pocket and putting in another, and is not the proper basis for a tax deduction.

To go on with some other point here, I will be as brief as I can. I think the facts will show, if we get into the question, oftentimes the parties would go to a [35] bank and borrow enough money so that they could make out a cashier's check, which would go to the Treasurer, and then he would hold that check and in exchange for it he would issue one purporting to pay bonds, coupons. All of this, I might say, is not principal. The principal amount



has never been changed, as I understand it. This all relates to interest, which is supposed to have been paid on the original assessment or situation arising out of the creation of the district and issuance of the bonds. I believe the record will be clear, in spite of what my good friend Mr. Acret says, there is no real tax angle. It was interest on that original obligation, if there was any. By the same token, it is interest on the coupons. About the same rate applies, 6 per cent, through here. We will have \$60,000.00 payment going through the Treasurer's office, ostensibly as an assessment or claim made by the county, and then the Treasurer pays out 6 per cent interest, which would be \$60,000.00. And that would be received by Mr. Birch as tax exempt interest. It involves the question of the law and regulations of tax exempt interest, with respect to moneys from a municipality. That is the way this thing has operated for years, if the Court please.

The Respondent's position is that the whole corporate entity of the Petitioner, particularly, should be entirely disregarded. That for all tax purposes the [36] corporation and Mr. Birch and his wife are one and the same thing. There is no real substance to the transactions giving rise to the deductions. Therefore, the Respondent contends that particularly in this proceeding relating to the years 1941 and 1942, first, there is no real issue or question before the Court showing error in the Commissioner's determination. And even if this 1940 allegation is relied upon there is no merit, no basis



in that and certainly it has not been shown, up to this point, that there is any basis for, that any legal liability or obligation calling for such payments, there is a serious question as to whether Petitioner actually made those payments. I do not even concede that.

The Court: Well, Mr. Crouter, as I understand the petitioner's position, it is that in 1942, Petitioner concedes that there are the deficiencies in income tax and excess profits tax, as determined by the Respondent, but prays an order of this Court in this proceeding, and which would be a part of the order fixing the amount definitely of the deficiencies to the effect that the Petitioner shall be entitled in a computation of its tax liabilities for the fiscal year ended September 30, 1942, to the carry back of a loss sustained in 1944, if it shall be finally determined in the proper proceeding that there is a loss in 1944.

Now, I take it, that such an order in this [37] proceeding would not be binding as to any question later arising with regard to the 1944 tax, but would merely safeguard the Petitioner as to 1942, in the event that there should be found a loss subject to carry-back in 1944. It would certainly seem to me premature in this proceeding to litigate a matter which has never passed through the final determinative processes of the Respondent, as to 1944. And it is hard for me to find how there is really much difference between the parties in this proceeding, which is the subject of litigation here.

Mr. Crouter: If the Court please, I don't mean to gloss over that. I appreciate the Court's position there. It seems to me, under my understanding of Section 122, it is quite possible or even probable that the 1944 question could be handled in that manner. As I recall, though, and I am just going by memory, I should have brought the code number, Section 122 (g) has a provision that decisions are subject to later renew or adjustment because of a net loss carry-back.

The Court: I admire counsel's temerity in even attempting to quote from 122 or 121, or any of those allied sections. That is 122 (g), you say?

Mr. Crouter: I appreciate I am hazarding a great deal.

Mr. Acet: I think your hazard is correct. I think that is correct, 122.

The Court: I think counsel had better look it up. I can't find it.

Mr. Crouter: We will be glad to go into that. I can appreciate this question quite possibly could be settled administratively between the Commissioner and the Petitioner here for the year 1944 or we might find ourselves back before your Honor or some other Judge litigating the 1944 case.

I can appreciate that properly belongs to a 1944 adjustment.

The Court: It would seem to me, while I appreciate from the statement of counsel that the question is a very interesting question, and I had a little bit of that problem in the Adler Realty Company case in which I finally ended up writing the dissent, but

it is a rather interesting problem. But I don't see how it can very well be presented in this proceeding.

Mr. Crouter: I had serious doubt about the jurisdiction. That is the reason I wanted particularly to point out the exact status of the pleadings here.

The Court: I do think that perhaps the pleadings are sufficient to justify the entering of an order of the kind outlined, that is, saying there is a deficiency subject to adjustments on account of a necessary loss [39] carry-back, if any.

Mr. Crouter: Yes.

Mr. Acret: Yes.

The Court: I would certainly not want to determine that in this proceeding. Now, I don't want to urge counsel to act unduly hastily in this case, because in matters of procedure one error can lead to an awful lot of resulting errors.

Do counsel feel there should be any evidence submitted in this proceeding?

Mr. Acret: I do, your Honor.

The Court: Such as the introduction in evidence of the findings of fact and opinion in the Turner case?

Mr. Acret: Here is what I propose to do, and I think possibly it would be agreeable to counsel, is to put in this letter, which establishes our information to date, and the findings of fact referred to in the letter, and a photostatic copy of our tax return showing the loss of \$84,000.00, and the virtual approval of that loss and increase of the loss by the position taken at this time by the Internal Re-

venue Agent in Charge. I think that is sufficient to give the Court jurisdiction to keep us open, the right to the carry-back. That is all. Automatically, if they don't go further with it, why, that will be sufficient. If they do go further with it, in common justice they are [40] protected; nobody is hurt. There is no issue as to 1944 that is before the Court or that we would be obliged to meet at this time.

Mr. Crouter: I might say, if the Court please, it isn't clear to me that would be a good method of procedure here. Certainly, on behalf of the Respondent, if the Petitioner admits, to go into the merits of the question of 1944 I must certainly protect myself and put in a good deal of evidence. We will find ourselves litigating the 1944 question.

The Court: I understand the Revenue Agent's letter, to which counsel refers, will not be submitted as proof to any of the facts set out therein or the existence of the losses referred to, but merely to prove that at the present time there has been an official recognition on the part of the Respondent there may be a net loss allowed in 1944.

Mr. Acret: That is it exactly. Further than that counsel doesn't need to worry, we are conceding the matter may be left open. We are conceding it isn't any decision on the merits.

The Court: It is obviously a matter of law. The Revenue Agent's report is the tentative proposition——

Mr. Acret: Yes.

The Court: ——and it must be construed in the



light [41] of the statements made by counsel for the Respondent that at the present time, so far as the Respondent counsel knows, the re-disposition with regard to 1944 is contrary to that taken by the Revenue Agent in the report referred to.

Mr. Crouter: That is correct. I wanted to clear it up. That is not agreed to by Respondent, as having any evidentiary value.

The Court: The Respondent does not agree that that now represents the Respondent's position on it, and the Respondent counsel does not agree any of the facts therein contained are true, but the Respondent does not deny, however, that that letter was written.

Mr. Crouter: That is correct.

The Court: Yes.

Mr. Acret: That being the case, we offer in evidence at this time the letter from the Internal Revenue Agent in Charge dated January 22, 1947, with three pages attached thereto.

The Court: I take it that that is offered in evidence for the purpose of showing that as of the date of that letter the Commissioner of Internal Revenue recognized there was an allowable net loss for the year 1944, is that correct?

Mr. Acret: That is right.

Mr. Crouter: And if the Court please, I will [42] object to that on the ground it is irrelevant and immaterial under the issues in this case. It is not final and there is no basis of estoppel or final action shown by the letter.



The Court: Objection overruled. Admitted for the purpose stated.

Mr. Acret: May we substitute a photostatic copy?

The Court: Leave granted.

The Clerk: Exhibit 1.

(The document above-referred to was received in evidence and marked Petitioner's Exhibit No. 1.)

The Court: It may be withdrawn and a photostatic copy substituted.

Mr. Acret: At this time we offer the findings of fact of the Tax Court in Docket 109993, excluding therefrom my pencil marks which are not a part of the exhibit.

The Court: Is there any objection?

Mr. Crouter: If your Honor please, yes. This involves a question which I don't want to prolong the proceedings with, but there are one or two things in there, if the Court please, I believe are inadvertent and they are not real facts. They are references to payments which were during that period when no payments were made. It may be based upon the testimony in the prior hearing. I know that the findings in the main are accurate and covers the picture. There are certain things in that that may prejudice [43] the Respondent's position. I cannot concede all those facts stated there are true and correct. I am prepared in this proceeding to prove the contrary to some of them.

I object on the ground they are references to

state court proceedings, which, as a matter of fact, were not real adversary proceedings. Respondent excepts and objects on that ground. I have prepared a summary of all the findings with the exception of the two matters I mentioned and agreed to stipulate with counsel to, in the event we proceeded. Those are the facts we would agree to. I have no objection to the findings and opinion going in for the information of the Court. I can't agree to the facts.

The Court: I question how important any of those facts contained in the memorandum and opinion and findings are in this case. Ultimately the question I have is a procedural question.

Mr. Crouter: I appreciate that, if your Honor please. We go from case to case. I don't want to be confronted with a 1944 case, particularly if I should be handling this, that back in 1947 I agreed those were facts.

The Court: Has counsel for Petitioner examined the summary of the facts mentioned by counsel for the Respondent?

Mr. Acret: I discussed them over the telephone with [44] counsel, and I understand he wanted to stipulate as to facts with certain conditions added to it, at least. Over the telephone I couldn't agree to that. But I would like to call your Honor's attention to the fact these findings of facts are the findings of fact referred to in Exhibit 1. Properly they should be supplemental to Exhibit 1.

Mr. Crouter: I have no objection to that going in merely for the Court's information and for consideration in making its ruling and order with

respect to the net loss carry-back question. I do not concede all the matters stated there are facts, and I do not wish to have the Commissioner prejudiced in any future proceeding of any kind in court or out with respect to anything I do now regarding this statement.

The Court: Well, I think that will have to go in in one way or another, for one purpose or another, that findings of Judge Turner.

Mr. Crouter: Yes.

Mr. Acret: Whatever the legal effect of that is is another matter that results just as a matter of law.

The Court: I will overrule the objection and it will be admitted in evidence.

The Clerk: Exhibit 2.

(The document above-referred to was received in evidence and marked Petitioner's Exhibit No. 2.) [45]

Mr. Acret: We offer in evidence at this time photostatic copies of Petitioner's income tax return for the fiscal year ending September 30, 1944.

The Court: Is there any objection?

Mr. Crouter: No objection to that.

The Court: It will be accepted in evidence.

The Clerk: Exhibit 3.

(The document above-referred to was received in evidence and marked Petitioner's Exhibit No. 3.)

Mr. Acret: With that Petitioner rests, upon the

request heretofore made in the opening statement that the Court allow the matter to be kept open upon the conditions heretofore stated by the Court.

The Court: I have as part of the record two motions made by the attorney for the Respondent squarely asking for the determinations of deficiency by this Court, as determined, which I took under advisement.

I think it might be well, in view of the rather unusual character of the motion made by you, Mr. Acet, that it should be reduced to writing and filed.

Mr. Acet: Yes. I am sure counsel and I can agree on it.

The Court: So I will have before me exactly what Petitioner suggests in this matter.

Mr. Acet: Counsel is easy to work with. [46] Nevertheless, we can get something out that will be agreeable.

The Court: Mr. Crouter, do you have any matters?

Mr. Crouter: No. If the Court please, in view of my understanding—and I want to briefly refer to that—this is not in any way, or any sense to be taken as an adjusting of 1944 fiscal year on the merits, but merely to hold open this question of carrying forward. Respondent does not offer evidence at this time.

The Court: I think it would be very difficult for me, on the facts I have before me, to make any determination. I don't see how I would really. I don't see at the present time the jurisdiction that I would have.

Mr. Crouter: Yes. I don't want anything to be construed against me by my silence.

The Court: It seems to me the only question I have to determine is do I, under the pleadings and the facts that are before me, have the right to make, in effect, a determination of deficiency, to enter an order re-determining the deficiency in the amount as determined, with a conditional qualification, so to speak, that in the ultimate amount to be paid by the Petitioner credit shall be given on account of a possible loss carry-back for 1944, in an amount which has not yet been determined and which I do not attempt or in any way purport to determine. [47]

Mr. Acret: That is it exactly.

The Court: In my experience there has never been such an order issued. It may well be under the statute such an order can be issued. So far as I know it has never been determined. Are counsel familiar with that?

Mr. Acret: I feel satisfied, your Honor, I have made some search. There is no precedence for it. There is no precedent for the particular situation we find ourselves in. Section 122 is, I am sure, one that leaves us the right to relief and if your Honor makes that open, why, it will keep the right to relief open.

The Court: But then the question comes up, assuming that you have the right to relief, what kind of relief is it, administrative relief which has to go through the Bureau of Internal Revenue, or is it a relief which can be prescribed in an order by



this Court, and that is something I don't know about.

Mr. Acret: Your Honor, it clearly is relief that may be prescribed by this Court. We made the necessary allegations and we asked in our petition for relief by the Court. If it weren't done in that way I don't think that we would be protected. It would be a jurisdictional question. The only reason we can be granted relief is we are before the Court with that question. We are before it with the facts alleged, for a relief prayed for. The alternative, [48] if we don't get the relief made under the errors assigned—there was no error made by the Commission—the fact we have a right to carry-back because of errors by the Commissioner, therefore, we couldn't assign an error.

We had a right when we brought this petition, and I take credit to myself for foreseeing this possibility, that we might not get anywhere with the Supreme Court, but, in any event, if we got the matter before the Court, this Court would then have jurisdiction to do justice and grant us a relief to any carry-back that it would appear we are entitled to.

So it is a question of relief by an order of the Court. That is what we are here for. We ask for that. The Court has jurisdiction to do that very thing.

The Court: As I understand it, the Petitioner rests?

Mr. Acret: Yes, your Honor, we rest.

The Court: And Respondent rests?

Mr. Crouter: That is correct. In response to your Honor's inquiry, I might say this: I don't know as it will have a great deal of effect on this. This question came up in connection with stipulated questions of corporate excess profits, particularly, and pursuant to instructions of our office in some of the stipulations we have included a provision that the deficiency so agreed upon is subject to [49] adjustment for any net loss carry-back, if any. That is being worked out, but I have never had a case exactly like that. I am content to submit this case under the circumstances your Honor has stated.

Mr. Acret: The Commissioner himself could grant administrative relief in addition, but the relief from your Honor is an order by the Court. It is our contention, I respectfully submit, your Honor.

The Court: The briefs will really not be elaborate briefs, in that there will not be much discussion of the facts. It will really be in the nature of memorandum more than briefs. I do think probably briefs should be filed, unless counsel can get together and agree.

Mr. Crouter referred to the evolution to administrative procedure in this matter. It might be that the evolution will disclose, say, a policy which will permit counsel to agree upon an order to be entered in this case.

Mr. Acret: What I was trying to do, your Honor, and I appreciate the situation that you are in, and the hundreds of these matters, was to get one of these that could be disposed of right now in a

clear cut manner so you won't have this one on your neck, at least, from now on. That is all. It could be disposed of without briefs or anything else, and it is one you wouldn't have to take home with you. [50]

The Court: Well, I, of course, would like it at the present time, and I think counsel are entitled to indicate their positions in briefs, so I will just make an order that briefs may be filed pursuant to the rules.

Mr. Acret: Very well, your Honor.

The Court: I again suggest to counsel for Petitioner that a written motion be filed embodying the matters outlined in your opening statement.

Mr. Acret: Yes, your Honor.

Mr. Crouter: Thank you.

The Court: Thank you.

(Whereupon, at 11:25 o'clock a.m., Monday, June 30, 1947, the hearing in the above-entitled matter was closed.)

Filed T.C.U.S. July 22, 1947. [51]

[Title of Tax Court and Cause.]

## MEMORANDUM FINDINGS OF FACT AND OPINION

Kern, Judge:

Respondent determined deficiencies in petitioner's income taxes and declared value excess-profits taxes for the taxable years ended September 30, 1941 and 1942, as follows:

Year	Income Tax	Declared Value Excess-Profits Tax
1941.....	\$ 7,833.44	\$4,565.41
1942.....	11,915.67	1,687.10

In its amended petition filed herein on July 25, 1945, petitioner alleged that the respondent erred in determining these deficiencies; and among the errors set out in the petition alleged that respondent erred in determining that petitioner was on the cash receipts and disbursements basis, and in disallowing "the deduction (claimed as taxes) of \$120,000 interest on \$2,000,000 of bonds issued by Reclamation District No. 2035 \* \* \* ."<sup>1</sup> In paragraph V (i) of the amended petition the following allegation of fact was made:

That during petitioner's fiscal year ending September 30, 1944, petitioner suffered a loss in the sum of \$73,556.88 by reason of the drilling and abandonment of an oil well known as the Stovall-Wilcoxson well, and the leasehold interest in connection therewith; that in the same year this petitioner suffered

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<sup>1</sup>The quoted language is taken from the notice of deficiency.

losses from sales of property other than capital assets as follows:

A 338-acre farm situated in Stanislaus

County, California.....	\$36,417.50
Lots 61, 112, 141, Tract 993 .....	1,160.00
Lots 32, 36, 60, 91, Tract 993 .....	1,520.00
Lots 87, 62, 189, 90, 108, Tract 993.....	1,730.00
Lot 201, Tract 993 .....	1,200.00
Store Building, 320 Venice Blvd., Los Angeles .....	5,500.00

that in its income tax return for said year petitioner listed and deducted all of the aforesaid items of loss in the total sum of \$121,084.38; that should this court deny any part of this petitioner's petition herein this petitioner desires to carry back to its fiscal year ending September 30, 1942, as much of said losses in the said sum of \$121,084.38, up to \$25,000.00 thereof, as may be necessary to offset any part of the said tax deficiencies involved herein.

In paragraph (i) of the prayer of the amended petition, petitioner asks as follows:

That should this court deny any part of this petitioner's petition herein that petitioner be adjudged entitled to carry back to its fiscal year ending September 30, 1942, as much of said losses in the said sum of \$121,084.38, up to \$25,000.00 thereof, as may be necessary to offset any part of the said deficiencies involved herein.

Respondent denied the material allegations of petitioner's amended petition by answer filed on August 29, 1945.



At the hearing held herein on June 30, 1947, counsel for petitioner conceded that there were deficiencies in tax as determined by respondent, but asked that the Court, in its decision to be entered in this proceeding, provide by order that the petitioner should be entitled, in computing its tax liability for the fiscal year 1942, to the carry-back of losses sustained in 1944, if it should be determined in the proper proceeding that there were losses in 1944 subject to carry-back. Respondent moved orally that a decision be entered in favor of respondent in the amounts of the deficiencies determined by him as to each of taxable years here involved. These motions taken under advisement.

Petitioner concedes that no net operating loss from 1944 may be carried back to 1941. As to petitioner's fiscal year ended September 30, 1941, and the deficiencies determined by respondent in petitioner's taxes for that year, respondent's motion is granted.

Upon brief the petitioner's position is stated as follows:

We respectfully submit that respondent's motion as to the determination of the deficiency for 1942, ought to be denied and that petitioner on the other hand ought to be granted temporary relief herein by this court's determination (in lieu of the granting of a motion) as follows:

1. That petitioner is entitled to carry back to the year 1942, such operating loss as it may have suffered during the year 1944.

2. That the existence of such operating loss for the year 1944 cannot be determined in this proceeding.

3. That the question of petitioner's right to a re-determination of the deficiency assessment for 1942 be held open until the commissioner's determination of the existence or non-existence of such operating loss shall have become final, or shall have become lost by the running of the statute of limitations.

At the hearing herein petitioner introduced in evidence its income and declared value excess-profits tax return for the fiscal year ended September 30, 1944, which showed net income in a minus figure of \$84,179.37 and reflected the loss alleged in the petition, a report of the internal revenue agent in charge, Los Angeles Division, covering the examination of its income tax return for that year, and the Memorandum Findings of Fact and Opinion entered by this Court on April 20, 1944, in the case of Birch Ranch and Oil Co., Docket No. 109993, which involved the tax liability of petitioner for the years 1937 and 1939. The report of the internal revenue agent made no adjustments with regard to petitioner's tax liability for the fiscal year 1944, but in the statement attached thereto adjusted the net income as disclosed by the return by increasing the net loss from \$84,179.37 to \$186,899.37. The report contains the following statement:

The additional Net Loss as shown in this report is brought about by the allowance, in full, of amounts

paid by the taxpayer in this fiscal year for assessment taxes on Reclamation District #2035. A part of the amount paid in this year covers amounts accrued on the corporation's books in prior years, and disallowed in the prior Agent's reports as deductions since the corporation was on a cash basis. For a breakdown of these amounts see Schedule 1-A of this report.

The findings as shown in this report were discussed with Mr. Robert K. Landrum, Secretary of the taxpayer corporation, who agreed to all the proposed adjustments shown in this report.

At the hearing herein counsel for respondent reaffirmed the denial contained in his answer relating to the ultimate fact of petitioner's operating losses for 1944, and stated that the report of the internal revenue agent in charge did not represent the respondent's position with regard thereto.

Respondent, on brief, contends that there is no evidence in the record upon which a finding can be made as to the amount, if any, of net loss carry-back from 1944 to 1942, to which petitioner is entitled; that this is an issue raised in the pleadings upon which petitioner has the burden of proof; that there has been a failure of proof; and that, since petitioner concedes the correct determination of the deficiencies for 1941 and 1942 (aside from the question of the net loss carry-back) unconditional and immediate decisions should be entered for the full amount of the deficiencies as determined by the respondent.

As we have pointed out, petitioner on brief takes the position "that the existence of [the] operating

loss for the year 1944 cannot be determined in this proceeding," while the respondent's position on brief is equally explicit that the operating loss for the year 1944 sought to be carried back to 1942 is an issue in this proceeding and must be decided herein.

The respective positions of counsel were not so definitely stated at the time of the hearing herein. Although the opening statements of counsel for the parties were quite long, it is not clear from a reading of the transcript, and was not clear at the trial, what their several contentions were. A fair statement of petitioner's position at the trial seems to be as follows: While certain allegations were made in the petition as to an operating loss in the taxable year 1944 which should be carried back to 1942, the only issue in this proceeding with regard to such a carry-back was the good faith of the petitioner in claiming it and the probability of its existence. The question of whether there was such an operating net loss in 1944, and its amount, would be decided on its merits in a proceeding involving the taxable year 1944, and only after that year had been considered administratively and with finality by the respondent, as by the issuance of a deficiency notice relating to that year. Pending such administrative action and a hearing on the merits as to the net operating loss for the taxable year 1944 in a proceeding relating to that year, petitioner requested an order in this proceeding safeguarding its right to a carry-back of such a loss, if, when and to the amount it was ultimately established.



Respondent's position at the trial seems to be fairly reflected by the following excerpt from his counsel's statement:

The same fiscal year ended September 30, 1944, which, under the two-year provision of Section 122, relating to carry-back, I assume Petitioner now desires to have carried back, and asserted for 1942.

Respondent on time and as soon as this petition was filed denied the allegation of fact, including subparagraph (i). I don't believe there is any question about that. That has been denied, since the Respondent's answer was filed on August 29, 1945. That remains denied, and that is still Respondent's position.

Now, with respect to these other losses referred to in that paragraph (i) at the top of page 19, Respondent does not contest other losses or deductions, except on account of this bond situation.

As I see this case, we still have undecided and pending for the Court's decision, if we have to go into that here, the question of whether Petitioner is entitled to deductions for this tax or interest. I think there is a very serious question whether that matter is properly before the Court. I believe that counsel has referred to that previously, in saying he appreciates there is no issue here regarding 1944.

Now, it is contended for administratively, and has been under consideration administratively, that is not final. It is not conceded that the Petitioner is entitled to those deductions, as counsel said, the statutes are still open. That is still a matter for the



Bureau of Internal Revenue for the prior years, 1941 and 1942.

If the Court rules that is a pending issue in this case and is properly before this Court and this is the appropriate time and place to go into it, the Respondent is prepared to go through and litigate that question.

The judge presiding at the hearing was not asked by either party during the hearing to rule, and did not then rule that the question of the existence and amount of the net operating loss carry-back from 1944 was an issue pending in the case, and one which should have been litigated in this proceeding. While he made no ruling on the question, he did indicate a reluctance to go into the question on the merits in the instant case, pointing out the difficulties incident to the judicial determination of the taxpayer's tax liability for one year by the determination of its net income or net operating loss for a later year which had not been subject to complete administrative audit and review, when the facts necessary to such determination were disputed by the parties. Cf. *Uni-Term Stevedoring Co.*, 3 T. C. 917; *Pioneer Parachute Co.*, 4 T. C. 27.

This recitation of the proceedings at the hearing herein necessary to present in a fair and complete manner the question which is now before us. That question, stated broadly, is whether the existence and amount of taxpayer's net operating loss for one year may be and, in this case are, issues to be determined by this Court in a proceeding involving its tax liability for a prior year to which the net oper-

ating loss for the later year is sought to be carried back, when the years in questions are not those covered by Section 3780 of the Internal Revenue Code.

It should be noted that sections 3779 and 3780 of the Internal Revenue Code, added by section 4 (a) of the Tax Adjustment Act of 1945, are not available to petitioner since they are applicable only to taxable years ending on or after September 30, 1945, and the net operating loss, sought to be carried back in the instant case is from the taxable year ended on September 30, 1944. If section 3780 had been available to petitioner it might have filed its application for a tentative carry-back adjustment of the taxes for the taxable year 1942 at any time within a year after the end of the year 1944 and might have thereby forced the Commissioner to take immediate administrative action with regard to such adjustments.

After a careful study of the question in the light of the briefs filed herein, we are now of the opinion that whether there is a net operating loss of petitioner for the taxable year 1944 and the amount thereof available as a carry-back to 1942 are issues in this proceeding and must be decided herein.

Petitioner is entitled to deduct from gross income a "net operating loss deduction computed under section 122." Section 23 (s), Internal Revenue Code, as added by section 211 (a), Revenue Act of 1939. Before 1942 the net operating loss deduction included "the amount of the net operating loss carry-over \* \* \*" from the two preceding years. It has never been questioned that with regard to a net oper-

ating loss carry-over from a preceding year, the existence and amount thereof is properly an issue in a proceeding involving a deficiency determined as to a later taxable year in which a taxpayer claims such carry-over under section 122. See *Moore, Inc.*, 4 T. C. 404, affirmed 151 Fed. (2d) 527; *Bush Terminal Building Co.*, 7 T. C. 793, 817; *Walter G. Morley*, 8 T. C. 904, 916. By the Revenue Act of 1942, the net operating loss deduction was made to include net operating loss carry-backs. Section 122 (b), Internal Revenue Code, as amended by section 153 (a) and (c) of the Revenue Act of 1942. The legislative history of this amendment indicates that Congress recognized that, in the usual case, a taxpayer could not determine the amount of the carry-back until the close of the future taxable year in which it sustained the net operating loss, and therefore would have to pay its tax without regard to that deduction, and later file a claim for refund. See Senate Report No. 1631, 77th Congress, 2nd Session, p. 123, C. B. 1942-2, p. 597.

In 1945 subsection 322 (g) was added to the Internal Revenue Code and made retroactive to 1941. That subsection reads as follows:

(g) Overpayments Attributable to Net Operating Loss Carry-Backs and Unused Excess Profits Credit Carry-Backs.—If the allowance of a credit or refund of an overpayment of tax attributable to a net operating loss carry-back or to an unused excess profits credit carry-back is otherwise prevented by the operation of any law or rule of law other than section 3761, relating to compromise, such

credit or refund may be allowed or made, if claim therefor is filed within the period provided in subsection (b) (6). If the allowance of an application, credit or refund of a decrease in tax determined under section 3780 (b) is otherwise prevented by the operation of any law or rule of law other than section 3761, such application, credit or refund may be allowed or made if application for a tentative carry-back adjustment is made within the period provided in section 3780 (a). In the case of any such claim for credit or refund of any such application for a tentative carry-back adjustment the determination by any court, including The Tax Court of the United States, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to the net operating loss deduction and the unused excess profits credit adjustment and the effect of such deduction or adjustment, to the extent that such deduction or adjustment is affected by a carry-back which was not in issue in such proceeding.

The report of the House Committee with regard to this subsection states in part as follows (House Report No. 849, 79th Cong., 1st Sess., pp. 31-32, reported in C. B. 1945 at p. 587):

In further recognition of the fact that the events which result in a net operating loss carry-back or an unused excess profits credit carry-back may not occur until a number of years after the close of the taxable year of the overpayment, subsection (d) of section 5 of the bill adds a new subsection (g) to section 322 of the Code. \* \* \* Section 322 (c) of the



Code in effect provides that where a taxpayer has filed a petition with The Tax Court for a redetermination of a tax for a taxable year, no credit or refund of an overpayment of such tax for such year, except as determined by The Tax Court and with certain other limited exceptions, may be allowed or made. However, under the proposed subsection (g) of section 322 of the Code, even though the tax liability for a given taxable year, for example, has already been litigated before The Tax Court, credit or refund of an overpayment attributable to a carry-back may be allowed and made, if claim for credit or refund is filed within the period prescribed in section 322 (b) (6), or if an application for a tentative carry-back adjustment is filed within the period prescribed in section 3780 (a). \* \* \*

Though it is the purpose of subsection (g) to permit taxpayers to receive credit or refund of an overpayment of tax resulting from a carry-back, even though such credit or refund normally would be barred by the doctrine of *res judicata* or by some other law or rule of law, it is not intended that any determination of issues, including carry-back issues, made by any court in a proceeding in which the decision has become final shall be open for reconsideration. Subsection (g) provides that in the case of a claim for credit or refund of an overpayment attributable to a carry-back, or in the case of an application for a tentative carry-back adjustment, the determination of any court, including The Tax Court, in any proceeding in which the decision of the court has become final, shall be conclusive except



with respect to the net operating loss deduction and the unused excess profits credit adjustment, and the effect of such deduction and adjustment, to the extent that such deduction or adjustment is affected by a carry-back which was not in issue in such proceeding. \* \* \* [Underscoring supplied.]

At the time of the Congressional enactment of all of the statutory provisions above referred to, section 272 (e) of the Internal Revenue Code provided that "The Board [of Tax Appeals] shall have jurisdiction to redetermine the correct amount of deficiency \* \* \*," and section 272 (g) provided as follows:

(g) Jurisdiction Over Other Taxable Years.—The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

No change or amendment to these subsections of section 272 are made, or purported to be made, by the statutes dealing with carry-backs.

In the instant proceeding the determination of deficiency as to the taxable year 1942 was made on April 30, 1945, and the original petition was filed on July 13, 1945. At those times petitioner's return for the year ended September 30, 1944, had been prepared and filed. Petitioner was then in a position to know and claim its right to an operating net loss deduction arising from a carry-back of its net operating loss for 1944 in the determination of its cor-

rest tax liability for its taxable year 1942. It could have also filed a claim for credit or refund on account of such reduction. The record does not show whether any such claim was filed. It does show, however, that it raised as an issue in this proceeding its right to a deduction in the taxable year 1942 on account of losses alleged to have been sustained in 1944, which can only be construed as an issue involving its right to a net operating loss deduction in 1942 arising from net operating losses in 1944 to which it was entitled as a carry-back under the provisions of section 122(b).

It is our conclusion that this issue is properly before us in this proceeding under the provisions of section 272 (e) and (g), and consequently, we must decide in this case whether petitioner sustained a net operating loss in 1944 and the amount thereof. See *Acampo Winery & Distilleries, Inc.*, 7 T. C. 629; *Weir Long Leaf Lumber Co.*, 9 T. C. 990.

With regard to petitioner's contention that the matter of its deficiency determined for 1942 to be held open "until the Commissioner's determination of the existence or nonexistence of such operating loss [for 1944] shall have become final, or shall have become lost by the running of the statute of limitations," there is no precedent for the procedure suggested by petitioner; and, in addition, no practical reason exists for inaugurating such a procedure. In the absence of some statutory provision similar to section 3780, Internal Revenue Code, above referred to, there is nothing to require respondent, in considering petitioner's tax liability for its fiscal year

1944 as disclosed by its return, to do more than determine whether petitioner had taxable income for that year. If he is satisfied that petitioner had no taxable income, the respondent is not required to make a determination of the existence or amount of petitioner's operating loss for that year. Only with regard to petitioner's tax liability for prior or subsequent years would such a determination be required, for the purpose of ascertaining net operating loss carry-backs or carry-overs. Therefore, as a practical matter, no useful purpose would be served by holding open the question of petitioner's correct tax liability for 1942 until respondent does something which he is not required to do.

Upon the proof contained in the record before us, we are unable to find the existence or amount of any net operating loss of petitioner in its fiscal year 1944 which would give rise to a net operating loss deduction in 1942, the year before us. *H. B. Moore*, 8 B.T.A. 749, 754.

However, because of the novelty of the procedural problems presented, the intimation by respondent's counsel that some adjustment or agreement might be made administratively with regard to the net operating loss carry-back claimed by petitioner, the grave consequences to petitioner of a conclusive determination in this case, evidently unanticipated by it, of any rights incident to its alleged net operating loss carry-back from 1944, and the fact that the Court did not direct petitioner to proceed at the hearing herein with its proof as to existence and amount of such loss carry-back, we feel that a some-

what unusual procedure should be followed in the disposition of this case in order to accomplish a fair and equitable result.

The parties will be given sixty days after the entering of this Opinion within which to submit an agreed computation of the correct tax liability of petitioner for its fiscal year 1942, or to otherwise move in regard thereto.

If, within that period, no such computation is submitted or no motion is filed by either party, then, pursuant to our Opinion that the existence and amount of petitioner's alleged net operating loss carry-back from 1944 is properly here at issue and have not been proved by the evidence submitted,

Decision will be entered for the respondent.

Entered Mar. 24, 1948.

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[Title of Tax Court and Cause.]

### MOTION TO REOPEN CASE

Pursuant to Memorandum of Opinion herein, dated March 24, 1948, petitioner hereby respectfully moves that this case be reopened and set for trial upon the issue as to whether petitioner suffered a net operating loss for the taxable year 1944 as alleged in the Petition herein and as stated in the report of Internal Revenue in Charge, dated January 23, 1947, admitted in evidence as Petitioner's Exhibit 1 herein, and as to whether Petitioner is entitled to carry-back such loss to the year 1942.



Dated: May 17, 1948.

/s/ GEORGE ACRET,  
Attorney for Petitioner.

Received and Filed T.C.U.S. May 21, 1948.

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[Title of Tax Court and Cause.]

### ORDER

Petitioner filed herein on May 21, 1948 its Motion asking that this case be reopened and set for trial upon the issue of whether petitioner sustained a net operating loss for the taxable year 1944 which is available to it as a carry-back to the taxable year 1942, and the amount thereof, if any. This motion was filed within the time granted in our Memorandum Opinion entered herein on March 24, 1948. Upon due consideration, it is

Ordered: that petitioner's said Motion be and it hereby is granted, and that this proceeding be and it hereby is reopened for the purpose of hearing evidence upon the issue above stated; and it is further

Ordered: that this proceeding be set for trial upon the issue above stated at the first Los Angeles calendar to be had after July 1, 1948.

[Seal] /s/ JOHN W. KERN,  
Judge.

Washington, D. C.

May 26, 1948.

Served May 26, 1948.



THE TAX COURT OF THE UNITED STATES

Docket No. 8720

BIRCH RANCH AND OIL COMPANY,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

October 11, 1948—10:00 a.m.

(Met pursuant to notice.)

Before: HONORABLE C. R. ARUNDELL,  
Judge.

Appearances:

G. ACRET,

1210 Quinby Building,  
Los Angeles, California, appearing  
for the Petitioner.

E. C. CROUTER,

Honorable Charles Oliphant, Chief  
Counsel, Bureau of Internal Revenue,  
appearing for the Respondent.

PROCEEDINGS

The Clerk: Docket No. 8720, The Birch Ranch  
and Oil Company.

Mr. Acret: George Acret for the Petitioner.

There is a motion for continuance in the matter which I understand will not be opposed, and it is on a legitimate ground, I believe; that is the fact that the issues have been changed since the previous partial hearing of this matter and the issues now are not joined, and both counsel and I feel that there should be an amended complaint so that I can get at the matter properly and possibly enter into certain stipulations that will shorten the time of trial.

Mr. Crouter: E. C. Crouter for the Respondent, if the Court please. With respect to this case, if your Honor please, I would like just to be allowed to make a short review of its present status. The case is on this hearing calendar for a rehearing or further hearing. It was submitted once before, and I believe the Court held that the question of carry-back loss—the only year open now is 1942, and there is a question of a carry-back net operating loss from 1944 back to the taxable year 1942 involved here. There is some uncertainty as to the pleadings. I might point out that the memorandum findings of fact on the testimony previously entered was dated March 24, 1948, and to date there has been no amended petition. However, I can concede that an amended petition here specifically setting [3\*] forth the taxpayer's position would undoubtedly be helpful in the further hearing and presentation of the case, and for those reasons I have no objection to the continuance, but I would like to have a time placed on it so that we can have this case at issue.

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\* Page numbering appearing at top of page of original Transcript of Record.

and have it presented sometime in the fairly near future.

Mr. Acret: We would ask leave to file an amendment to the petition within thirty days, and we would be ready for trial at any time after counsel have an opportunity to answer that amendment.

Mr. Crouter: That seems reasonable to me.

The Court: I don't quite know what happened in this case. I see an opinion here by Judge Kern. Did he set the case down for further hearing, or what?

Mr. Acret: I might supplement counsel's remark, your Honor. The part that was heard with respect to this case was the question whether or not this Court had jurisdiction in a matter concerning a deficiency for 1942 to determine on the merits the question of a net operating loss in the year 1944. The Court took that question under submission, and found it to be an unusual procedural question and held that the Court did have jurisdiction to determine the question of the 1944 net operating loss. However, since that hearing there has been a reaudit of the taxpayer's books and a thirty day letter filed by the agent in charge, which changes the issues. There has been a question in my mind that the thirty day letter is not [4] final, and for that reason up to this time we have not filed an amendment to the petition. I think counsel will stipulate with me that that thirty day letter as filed is final, and if so we can file our amendment and join issues. The situation is that the issues were changed during the pendency of this action, and we have not had opportunity to reframe them.

Mr. Crouter: If your Honor please, I would not

go along with counsel in what he was stating. It seems to me that a lot of that bears on the merits of the case. To answer the question your Honor asked, the opinion entered March 24, 1948, provided that decision would be entered, provided that within a designated time neither party submitted a motion for further proceedings. Now, the Petitioner about May 21, 1948 did submit a motion for further proceedings with respect to the net operating loss question and that motion was granted, so that that in effect has provided for further proceedings in the case merely as to the net operating loss carry-back question.

The Court: Well, isn't that more or less of a mathematical problem?

Mr. Acret: No, your Honor. It is a very complicated question and involves the fact that it is a reorganization of a reclamation district. The matter has been litigated and I believe there is no issue about what Judge Turner found with regard to the organization of the reclamation district, but counsel has re-raised the issue, and unless there would [5] be some stipulation of facts, there is an enormous amount of evidence to be presented concerning the organization of that district, which ultimately involves our right to make the deduction for payment of interest on the reclamation bonds. It is a \$120,000 deduction. If we were allowed to make that deduction we would suffer a net operating loss we have the right to carry back.

The Court: Well, will that case come up in the regular order covering the year 1944?



Mr. Crouter: No, if you Honor please, because there is no deficiency determined for that year.

Mr. Acret: That is what makes the difficulty. There is no deficiency.

The Court: How are you going to get a final determination of it?

Mr. Crouter: Well, the Bureau has acted upon the matter since the last hearing, and the Petitioner has had a notice disallowing the loss contended for in 1944, so that the Bureau has taken a position and the Petitioner does not agree with it. I might also state for your Honor's understanding we have already worked out a settlement of the carry-back deduction in the matter of 1944, which is very similar, and in a similar issue to that which was involved in the years 1942 and 1941, and which was also involved in this prior case of 1941, and 1941 is out of it now. I might state that the Bureau has had the same difficulty [6] that was involved in the case decided by Judge Turner as to the years 1937 and 1939, but that case went off on an accounting basis, and this precise question has never been decided. That is our difficulty.

The Court: Well, as I understand it, we have to decide this case for the years September 30, 1941 to September 30, 1942. What you propose to do is to carry back a loss of 1944 and apply it in these earlier years, is that correct?

Mr. Crouter: To the year 1942. By this reply the Commissioner states there is no loss allowable as a carry-back. That is the Commissioner's last action.

The Court: What I am trying to find out is, are



we going to litigate in this 1942 proceeding, the 1944 proceeding, to determine whether there is a carry back?

Mr. Crouter: I believe it is necessary, and I believe that is the conclusion which Judge Kern reached after hearing this prior case, the prior proceedings rather in this same case.

Mr. Acret: Your Honor would have to read this opinion to see how he reached the decision, but there is no other way for the taxpayer to secure relief. To secure justice it is necessary. We raised the question in our petition. Since we filed that petition the agent in charge made a reaudit and filed a thirty day letter, that is, since the hearing of this case another audit was made and another thirty day letter has been filed, and it is the issues that are raised on that new letter that we [7] have not yet filed an amendment concerning, and which we now desire to do, and we could do that within thirty days, and then the matter could be tried on the merits in accordance with Judge Kern's decision.

Mr. Crouter: If your Honor please, I have a copy of the memorandum findings of fact and opinion previously rendered, and I believe the last three paragraphs will serve to help answer your Honor's question.

The Court: I think I have it.

Mr. Crouter: The last three paragraphs, as I have outlined them, do provide for further proceedings if counsel has requested, and it is for that reason that Respondent agrees to that procedure.

The Court: Is there any way for a taxpayer to

get the benefit of a net loss after the prior year has been determined?

Mr. Crouter: I believe there is, if your Honor please, if it is not put in issue in a pending docketed case. That was one of the difficulties here, the pleadings were a little bit indefinite, and Judge Kern finally, after going over the pleadings as I recall this, very squarely held that this net loss carry-back question is an issue in this case. It was not fully brought out in the pleadings, but a little bit obscure, and it is provided in the statute which is quoted in the opinion, if your Honor please, the last sentence of that [8] decision.

The Court: I understand that carry-back, but what I have in mind is, suppose that the year 1942 is litigated before us and we determine a deficiency. Now ordinarily that becomes final, in the absence of an appeal. Well, now, later on it develops that there is a carry-back. What happens?

Mr. Crouter: My understanding is this, if the carry-back question is not in issue in the proceeding, then under the statute and the procedure the case is subject to adjustment for a net loss carry-back. That sometimes happens in cases where we stipulate. We had no loss carry-back question involved on the original pleadings in this case, therefore the case fell within the last sentence of the statute which is 322 (g) of the Internal Revenue Code. I will read that if the Court thinks it would be helpful here.

The Court: I don't know, but it seems to me it is not a very orderly way of handling these matters.

Mr. Acret: There is another point involved

necessarily with this question. The question as to deficiency in 1942 has not yet been decided. That was not considered on the merits of whether or not, if they had a right to make a deduction in 1941 of \$120,000, whether or not they had a right to make it concerning the year 1942. Now, either of those questions is open for decision on the merits in this case, and the decision of either of them eliminates the deficiency. [8-A]

If this Court finds that the reclamation district is properly organized and that the taxpayer has the right to make that \$120,000 deduction for 1942, in either case the deficiency is wiped out, so your Honor's assumption that the 1942 deficiency had been decided on the merits, I think, is not the fact.

The Court: Well, I don't mean that it has been necessarily decided on the merits, but there was a determination by the Respondent for 1942, and you brought the proceedings here.

Mr. Acret: Yes.

The Court: And you could have raised anything on the merits that you saw fit. Well, if you didn't it is too bad, and now the case is decided and I would not think that the procedure should be to hold up a 1942 deficiency to see if some later year you might happen to get a loss that you could carry back.

Mr. Acret: That is the question.

The Court: If you do, it seems to me the revenue is going to be tied up for years in these cases just to see what the future may bring forth.

Mr. Acret: Of course, we don't enjoy having the

matter held up and drawing interest on it either, your Honor, but the question that your Honor is now suggesting is the question that was gone into in the previous hearing and which was decided [9] by Judge Kern, and I think is *res judicata* to that extent.

The Court: Well, I will let him worry with it then in the opinion. It seems to me that the matter should be disposed of, and I would suggest that you get your amended petition in within 10 days, and let's get it at issue so that we can get it on the November calendar.

Mr. Acret: It would be rather difficult to do that, your Honor.

The Court: Why so?

Mr. Acret: The present petition is I think a thirty or forty page printed petition, and the issues are quite substantially changed by this recent thirty day letter, and it would take longer than that if I went to work immediately on it. It took thirty days to prepare that first petition, and we attorneys have other work as well. It would be a rather difficult, if not impossible situation, to file amendment within 10 days.

The Court: What I had in mind is, you asked that this case be reopened in May. You have had since May, haven't you?

Mr. Acret: Yes, that is true, your Honor, but I have taken the position that this letter is the same situation we were in with reference to the first hearing; it is not the finality of review that Judge Kern refers to in his opinion and his decision at that time,



that the issue can't possibly be joined, and while he had this matter under consideration the [10] first thirty day letter has now been changed to another thirty day letter, and we are still in the same situation we were before at the time of the first hearing, there is no finality of review, but I think counsel and I now, knowing that situation, can meet that by treating that as a final decision of agent in charge and join issue on it, but it will take longer than ten days to do it intelligently and with sufficient care to do it properly, as far as the rights of my client are concerned. I would ask for thirty days, if your Honor please. My client is fully able to respond to any amount of tax, and we ourselves regret the loss of time on account of the interest that is running.

The Court: All right, I will allow you thirty days.

Mr. Acret: Thank you.

The Court: How much time do you have to have to answer it?

Mr. Crouter: Twenty days, I believe if counsel will give me a copy of the amended petition as soon as forwarded, why then even ten days from date of filing would be sufficient.

Mr. Acret: That is my practice, and I will be pleased to do so.

Mr. Crouter: Then we will probably have an early calendar in 1949 and might be able to get to it then.

The Court: Well, I will give you 15 days then, to answer.

Mr. Crouter: Thank you, your Honor.



(Whereupon the above-entitled matter was continued generally.)

Filed T.C.U.S. November 4, 1948. [11]

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[Title of Tax Court and Cause.]

SUPPLEMENT AND AMENDMENT  
TO PETITION

Comes now the petitioner Birch Ranch & Oil Company, a corporation, with leave of court first had and obtained, and for its Supplement and Amendment to its Petition herein, alleges as follows:

I.

That petitioner by reference hereby incorporates each and every statement and allegation contained in paragraphs I to V of its Petition on file herein.

II.

That in Docket No. 109993 in an action concerning this petitioner entitled Birch Ranch & Oil Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent, the above entitled court filed Findings of Fact finding and determining that Reclamation District No. 2035 is a bona fide reclamation district of the State of California; that this petitioner is the owner of lands situated in such district; and that such lands are subject to an accrual of taxes in the sum of \$120,000 per year for payment of interest upon bonds in the total sum of \$2,000,000 covering such lands and the principal of

which bonds, including accruing interest thereon, constitute a lien upon such lands until paid; that such Findings of Fact are contained in the Findings of Fact and Opinion filed in such Docket No. 109993 on April 20, 1944, that such Findings of Fact by reference are hereby made a part hereof.

### III.

That subsequent to the filing of said Findings of Fact, and pursuant thereto, respondent made a re-audit of petitioner's income tax return for the fiscal year ending September 30, 1944 in which respondent found and determined that petitioner's books and records are kept on a cash basis and that petitioner paid in cash as taxes an assessment of \$221,610.87 to such Reclamation District No. 2035 during the said fiscal year to cover accrued interest upon such bonds for such year, and that such deduction is a proper item of deduction; that a copy of such report is hereto attached as petitioner's Exhibit "1," that in such report respondent found and determined that petitioner suffered a net loss of \$102,720.00 during such fiscal year ending September 30, 1944.

### IV.

That notwithstanding such determination of such net loss for such fiscal year, respondent did thereafter under date of December 8, 1947, file a Second Report with respect to petitioner's income tax return for such fiscal year in which report respondent disallowed such deduction of \$221,610.87; and that as a result of such disallowance of such deduction

determined that petitioner had a net income for such taxable year of \$34,711.50, such disallowance being made upon the ground stated in such report as follows:

“For the history of the taxpayer see prior Agent’s reports and U. S. Tax Court’s findings of fact and opinion in re: Birch Ranch & Oil Co. vs. Commissioner, Docket No. 109993.

“The additional Net loss as shown in this report is brought about by the allowance, in full, of amounts paid by the taxpayer in this fiscal year for assessment taxes on Reclamation District #2035. A part of the amount paid in this year covers amounts accrued on the corporation’s books in prior years, and disallowed in the prior Agent’s reports as deductions since the corporation was on a cash basis. For a breakdown of these amounts see Schedule 1-A of this report.”

that a copy of pages 1, 2 and 8 of such report are hereto attached as Exhibit “2” hereof.

#### V.

That with respect to the last named report, the respondent erred as follows: in disallowing said deduction in said sum of \$221,610.87; in holding that petitioner did not suffer such net loss of \$102,720.; in determining that Reclamation District No. 2035 is not a bona fide political subdivision of the State of California; in holding that the interest accruing thereon does not constitute a bona fide lien against petitioner’s land until paid and that such assessment taxes, when paid, are not properly deductible as assessment taxes paid.

## VI.

That petitioner in fact paid assessment taxes to the Treasurer of Yolo County, California, to cover interest of such bonds accruing as a lien against petitioner's land for such current year, as stated in respondents' said report dated January 23, 1947, as follows:

the Treasurer of Yolo County, California.....	\$123,516.10
the Treasurer of Yolo County California .....	\$123,516.10
Less: Amounts previously paid .....	(5,394.72)
Plus: Amount not previously accrued on books, but paid in current year on old Calls .....	769.49*
Total.....	<u>\$118,890.87</u>

Amounts allowed in this report consist of four payments in this year, by Certified Checks as follows:

(1) Check No. 28553 Dated 12/29/43 .....	\$ 64,422.51
(2) Check No. 29537 Dated 6/28/44 .....	59,093.59
(3) Check No. 20778 Dated 8/12/44 .....	37,325.28
(4) Check No. 618 Dated 9/20/44 .....	60,769.49*
Total.....	<u>\$221,610.87''</u>

## VII.

That petitioner in fact suffered an operating loss for such fiscal year in said sum of \$102,720 as established by respondents' such report dated January 23, 1947.

## VIII.

That petitioner by reference hereby incorporates Opinion of the Honorable John W. Kern filed herein in June 30, 1947, as part of this Supplement and Amendment.

Wherefore, petitioner prays that it have relief as prayed in its petition herein with respect to its fiscal year ending September 30, 1942, and that in addi-

tion, in the event this Court should deny petitioner any part of such relief as prayed for in such petition with respect to the said year ending September 30, 1942, that petitioner be adjudged entitled to carry back such part of such operating loss for such fiscal year ending September 30, 1944, as may be necessary to off-set any part of any deficiency involving such fiscal year ending September 30, 1942.

/s/ GEORGE ACRET,

Attorney for Petitioner.

Received and Filed T. C. U. S. November 12, 1948.

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[Title of Tax Court and Cause.]

ANSWER TO PETITIONER'S SUPPLEMENT  
AND AMENDMENT TO PETITION

The Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, for answer to the Supplement and Amendment to Petition heretofore filed in this proceeding, admits and denies as follows:

I.

In response to the allegations contained in paragraph I of the Supplement and Amendment to Petition, the respondent relies upon and hereby incorporates by reference the allegations contained in paragraphs I through VI and all sub-divisions thereof in the respondent's answer previously filed on or about August 29, 1945.



## II and III.

The respondent denies the allegations contained in paragraphs II and III of the Supplement and Amendment to Petition.

## IV.

Admits that the respondent has made a determination of a disallowance of a deduction claimed by the petitioner for the taxable year 1944 in the amount of \$221,610.87 for alleged taxes or interest paid, and that as a result of such disallowance the respondent has found and determined that petitioner had no net loss carry-back from 1944 to the taxable year 1942; admits that a copy of pages 1, 2 and 8 of the last report, of December 8, 1947, is attached to the Amendment to Petition; and the respondent denies the remaining allegations of paragraph IV of the Supplement and Amendment to Petition.

## V.

The respondent denies the allegations of error contained in paragraph V of the Supplement and Amendment to Petition.

## VI and VII.

The respondent denies the allegations contained in paragraphs VI and VII of the Supplement and Amendment to Petition.

## VIII.

The reference in paragraph VIII of the Supplement and Amendment to Petition to the prior opinion of the Honorable John W. Kern, filed herein on

March 24, 1948, under the Court's rules, apparently requires no admission or denial by the respondent.

IX.

The respondent further denies that the petitioner is entitled to any deduction for interest or taxes paid during 1942 and 1944 and alleges that it is not entitled to any net-loss carry-back from the year 1944 to the year 1942, on account of payment of any interest or taxes during 1944, under any of the provisions of Section 122 of the Internal Revenue Code.

Wherefore, it is prayed that the respondent's determination of deficiencies for the taxable year 1941 and 1942 be sustained and approved, and that the petitioner's alleged net-loss carry-back from the taxable year 1944 to the taxable year 1942 be denied.

/s/ CHARLES OLIPHANT,

ECC,

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,

Division Counsel.

E. C. CROUTER,

Special Attorney,

Bureau of Internal Revenue.

Received and Filed T.C.U.S. December 1, 1948.

[Title of Tax Court and Cause]

### STIPULATION OF FACTS

It is hereby stipulated and agreed, by and between the parties hereto, by their respective counsel, that the following facts may be taken as true, without prejudice to the right of either party to introduce other and further evidence not inconsistent therewith, and subject to the exception stated at pages 15-16, below:

1. The petitioner is a Nevada corporation, with its principal office in Los Angeles, California. Its income tax returns for the years involved herein were filed with the Collector of Internal Revenue in that city.

2. The Menges Oil Company, a corporation, was the owner of partially developed oil lands in the Brea Oil Field, in Orange County, California. The stock of the corporation was owned by A. Otis Birch, his wife, M. Estele C. Birch, B. F. Conaway, his wife, Anna M. Conaway, Louise Smith and her sister, Ruth Smith. The Conaways were the parents of Mrs. Birch, and the Smith sisters were the nieces of Birch. Louise Smith married C. Harold Hopkins, and Ruth his brother, J. J. Hopkins. They are commonly referred to in this proceedings as the Hopkins sisters. Birch and his wife and Conaway and his wife owned in equal amounts 70-17/18 per cent of the stock of the Menges Oil Company and the Hopkins sisters similarly owned the balance of 29-1/8 per cent. The Menges Oil Company was dis-

solved in September 1911, and its assets were transferred to a partnership known as Birch Oil Company. The stockholders of the Menges Oil Company became partners in the Birch Oil Company and their interests in the partnership were in the same proportions as their stock ownership in the corporation had been.

3. In 1914 Birch Oil Company purchased about 13,000 acres of overflow lands situated about five miles from Sacramento, in Yolo County, California, and in the Sacramento River Valley. The lands were purchased for use in farming and stock raising, and came to be known as the Conaway Ranch. Additional acreage was thereafter purchased and by 1918 the ranch contained about 20,000 acres. All purchases had been made at \$35 per acre.

4. At the time of the original purchase in 1914, the Sacramento and San Joaquin Drainage District, created under the laws of California, had started a flood control project in Sacramento River Valley. The project called for the acquisition of a by-pass, known herein as Yolo By-pass, across the Conaway Ranch, for the passage of excess floodwaters of the Sacramento River and its tributaries.

5. In 1914, when Birch Oil Company purchased the first of the lands comprising the Conaway Ranch, the by-pass was being surveyed, and it was expected that about one-half of the ranch would be taken for that purpose. The Reclamation Board of the State of California informed Birch Oil Company that if it would construct a levee across its

ranch property, adjacent to the by-pass, an assessment would be made against all the lands in the Sacramento and San Joaquin Drainage District to pay Birch Oil Company for flowage rights through the by-pass and for the construction of the levee. Birch Oil Company expected to receive \$25 an acre for the acreage used for the by-pass. Such acreage, according to law, could not be fully reclaimed and was suitable for grazing only.

6. Desiring to reclaim and develop the lands comprising the Conaway Ranch, the Birch Oil Company, in 1918, filed a petition with the Board of Supervisors of Yolo County, California, for the creation of a reclamation district which would include 24,210 acres and would cover the whole of the Conaway Ranch and twenty-odd other parcels of land not owned by the Birch Oil Company or its members. In April 1919, the establishment of Reclamation District No. 2035, comprising approximately 21,000 acres, was approved by the Board of Supervisors. Excluded from the district as approved were some 1,300 acres of the Conaway Ranch and all except eight of the twenty-odd other parcels of land not owned by the Birch Oil Company or its members.

7. Organization of the district was completed and the County Board of Supervisors appointed Conaway, C. Harold Hopkins, and a man named Armfield as trustees for the district. In June 1919, the trustees employed an engineer and directed him to prepare plans for the reclamation and irrigation of lands in the district, with estimates of the cost of



the necessary improvements. In June, 1920, the trustees approved the plans submitted by the engineer and his estimate of \$2,264,740 as the cost of the improvements. The plans submitted called for the construction of the main levee along the edge of the Yolo By-pass, as above described. The plans were approved by the Reclamation Board of the State of California in October 1920, and in December of the same year, by the Board of Supervisors. Commissioners of assessment were appointed to assess the value of the benefits to the lands in the district from the improvements contemplated and to apportion the cost of said improvements according to the benefits that would accrue to each tract of land in the district. Thereafter, and prior to July 2, 1924, the commissioners made the assessment and apportionment for which they were appointed. The assessment was approved by the Board of Supervisors on July 23, 1924, and the list of assessment was filed on the same day with the County Treasurer of Yolo County.

8. The Birch Oil Company, under the direction of the district's engineer, built the improvements called for in the reclamation plan and financed all the costs, which were slightly in excess of two million dollars. The work was substantially completed by 1925, at which time the improvements consisted of 45 miles of roadways, 47 miles of irrigation canals, 55 miles of drainage canals and ditches, and included bridges, pumping plants and other structures necessary for the development of the lands in

the district. By 1925 Birch had acquired individually and at undisclosed costs seven of the eight parcels of land which with the Conaway Ranch comprised the land of the district. The parcel not so purchased consisted of 240 acres.

9. In the meantime, the Hopkins sisters, being desirous of disposing of their interests in the Conaway Ranch, by agreements dated January 1, 1924, sold such interests to Birch and Mrs. Birch for \$787,000, an amount designed to pay them their proportionate part of the Birch Oil Company funds invested in the ranch. Under the agreements each of the sisters agreed to accept bonds of Reclamation District No. 2035 in the principal amount of \$393,000 and cash in the sum of \$500. Birch and his wife agreed to cause the district to issue bonds in an amount of at least \$800,000, which were to constitute a prior lien on all of the property in the district, and further promised to deliver on or before February 1, 1925, to each of the sisters the amount of the bonds and cash called for by the agreements. Birch and his wife were to have immediate and absolute possession and control of the properties acquired from the Hopkins sisters and were to be entitled to all rents and profits of every kind therefrom and were to assume all liabilities and burdens incident to the ownership thereof. The bonds not having been issued at the time of the agreements on January 1, 1924, Birch gave to each of the sisters his promissory note in an amount equal to the amount of the bonds she was entitled to receive under the agree-

ments. The notes were to run for 10 years and were to draw interest at 6 per cent per annum from January 1, 1924, for a period of 5 years, and at 7 per cent thereafter. Birch had the option of paying the notes in full at any time prior to the expiration of the 10 year period.

10. According to the minutes, the landowners, at an election held on August 28, 1924, voted to issue bonds to pay for the reclamation work which had been done, and on October 26, 1924, the trustees adopted resolutions providing for the issuance of the bonds.

11. On January 5, 1925, the trustees of the district adopted resolutions directing that the district pay Birch and Conaway \$2,000,000 for moneys advanced in the construction of the improvements; that Warrant No. 1 of the district be issued to them in that amount; that the bonds of the district be placed in the hands of the County Treasurer; and that the County Treasurer be requested to advertise the bonds for sale at the earliest possible date. On the same day Warrant No. 1 for \$2,000,000, drawn on the Treasurer of Yolo County, was issued to Conaway and Birch. The warrant was approved by the Board of Supervisors of Yolo County and was presented for payment to the County Treasurer but was not paid for want of funds.

12. On January 7, 1925, the trustees of the district delivered to the County Treasurer bonds of the district totaling \$2,264,740. The bonds were dated January 1, 1925, and bore interest at the rate of 6 per cent per annum until paid. They were in denom-

inations of \$1,000. The first \$227,000 thereof were to mature on January 1, 1935, with a like amount maturing on January 1 of each year following until January 1, 1944, when the bonds then remaining and amounting to \$221,740, were to mature. Also on January 7, 1925, the County Treasurer gave notice that on January 23, 1925, he would sell Bonds Nos. 1 to 2,000, inclusive, of \$2,000,000 par value, to the highest bidder, and stated that outstanding warrants of the district, with accrued interest thereon, would be accepted in payment for the bonds. Birch, acting for himself, Mrs. Birch and the Conaways, was the highest bidder, his bid being \$2,000,000 plus accrued interest. Being the highest bidder, he became the purchaser of the bonds and gave in payment therefor Warrant No. 1 of the district, which had been received by him and Conaway in payment for the building of the improvements for the district.

13. Upon receipt of the bonds of the district, Birch delivered to each of the Hopkins sisters \$393,000 par value of such bonds, or a total of \$786,000 pursuant to the agreements of January 1, 1924, whereunder he and his wife had acquired from the Hopkins sisters all of the interests of the latter in the Conaway Ranch. Upon delivery of the bonds, the Hopkins sisters delivered to Birch the promissory notes covering the purchase price of their interests in the ranch which had been received from him at the time of the January 1, 1924 agreements. At the same time they made formal conveyance to Birch and his wife of all their interests in the Conaway Ranch.



14. At or about the same time and pursuant to the terms of agreements dated January 10, 1925, the Hopkins sisters granted to Birch and his wife the right to purchase the bonds received by them as above set forth, at the prices and on the terms set forth in the said agreements. According to these agreements, Birch and his wife offered and agreed to purchase at face the bonds in question, the purchases from each sister to be made in installments of \$39,300 on January 1, 1926, and on January 1 of each year thereafter until January 1, 1933, with a final installment of \$78,600 on January 1, 1934, and on each purchase date to buy all matured coupons appertaining to the bonds covered in the particular installment. At each installment date the sale of the bonds by the Hopkins sisters to Birch and his wife was to be completed at the option of the Hopkins sisters. To assure payment for the respective installments of the bonds, Birch and his wife agreed to deliver to B. F. Conaway and C. Harold Hopkins, as trustees, the balance of the district's outstanding bonds in the amount of \$1,214,000, and upon default in the payment of any of the above installments, the Hopkins sisters were to be permitted to sell, or have sold, so much of the bonds held in trust as should be required to pay the amount in default. The trustees might also release to Birch and his wife such of the bonds as might be required by them as a pledge for money borrowed to pay any current installment. Otherwise the bonds held in trust were to be released by the trustees only upon the written consent of the Hopkins sisters or upon full performance of the



agreements by Birch and his wife. In the event the Hopkins sisters should elect at any installment date not to sell the bonds called for by the agreements, Birch and his wife had the option to declare the agreement at an end. Provision was also made that Birch and his wife, on 90 days notice, might elect to buy bonds in advance of the regular installment dates provided and similarly might declare the entire agreement at an end if the Hopkins sisters should reject the offer. In respect of all purchases prior to January 1, 1929, Birch and his wife were to pay interest at the rate of six per cent, the rate called for by the bonds. On purchases after that date, they were obligated to pay seven per cent or one per cent over the interest provided for in the bonds.

15. In 1926 Birch entered into an agreement with the Conaways for the purchase of their interests in the ranch and in the bonds of Reclamation District No. 2035. The purchase price was paid in cash and in installments.

16. Beginning with January 1, 1926, the first installment date under the agreements of January 10, 1925, the Hopkins sisters elected to sell the bonds to Birch and his wife pursuant to the terms of the said agreements. Birch and his wife made the payments on the bond purchases as called for in the agreements and as elected by the Hopkins sisters until the early 1930's, when, due to the depression and a resulting lack of funds, they were unable to make the further payments on the dates prescribed, and extensions of time have thereafter been allowed.

The bonds paid for in the face amount of \$476,000 were delivered to Birch and his wife. The Hopkins sisters, in April, 1943\*, still held the remaining \$310,000 of the said bonds, but still held Birch and his wife liable on their obligations under the agreements of January 10, 1925. Their interest is in the receipt of the cash payments provided for in the contracts and they are unwilling to accept anything else. Of the \$476,000 par value of the bonds paid for by Birch and his wife and received from the Hopkins sisters, \$10,000 par value of such bonds were sold to Lula M. Minter and \$86,000 passed into the hands of the Great Republic Life Insurance Company, a corporation of which Birch was president. There was later a dispute between petitioner and the insurance company over rights of petitioner in and to the said bonds, the exact basis for which dispute is not shown.

17. On October 15, 1934, Birch and his wife organized Birch Ranch and Oil Company, the petitioner herein, and transferred to it the Conaway Ranch, their interest in the Birch Oil Company, the partnership which succeeded the Menges Oil Company in 1911, and all other property belonging to them, except the bonds of Reclamation District No. 2035, certain corporate stock and other properties having a value of about \$600,000. Birch had been having difficulties during the depression years in

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\*On April 5 and 6, 1943, The Tax Court heard the case of Birch Ranch and Oil Company, Dkt. 109993, Mem. Op. entered Apr. 20, 1944, which related to the years 1937 and 1939.

borrowing on his personal credit the moneys needed for the operation of the ranch, and the petitioner was organized for the purpose of procuring needed bank credit.

18. Also on October 15, 1934, Birch and his wife organized a second Nevada corporation, to be known as Birch Securities Company. To that corporation they transferred \$1,594,000 par value of the bonds of Reclamation District No. 2035, being all of the bonds of the district except the \$310,000 still in the hands of the Hopkins sisters and those held by the insurance company and Lula M. Minter. Of the bonds so transferred, \$1,214,000 were transferred subject to the trust under the contract with the Hopkins sisters. In addition, they transferred to the Securities Company the corporate stocks referred to in the preceding paragraph. Birch Securities Company was organized as a holding company, and solely for the personal convenience of Birch. It engaged in no other business than that of a holding company.

19. Birch and his wife also organized on October 15, 1934, a corporation known as the Birch Holding Company, and transferred to it the stock of the petitioner and that of Birch Securities Company, which stock had been received by them for the assets transferred to such corporations. Birch received 49 per cent of the stock of the Holding Company, and his wife 51 per cent. Birch Holding Company was organized solely for the purpose of holding the stock of the petitioner and that of Birch Securities Company. It has not conducted any

other business. Birch became president of the three corporations. Mrs. Birch has left to him the determination of all matters pertaining to the administration of the affairs of the three corporations.

20. Beginning with 1937, and until April, 1943, no amount was paid in any year by the petitioner as interest on the \$1,594,000 of such bonds transferred by Birch and his wife to the Birch Securities Company, nor has it paid any amount as interest on the \$86,000 of such bonds held by the Great Republic Life Insurance Company. As to the bonds held by the insurance company, there was a dispute between that company and petitioner over petitioner's rights in and to those bonds. They were ultimately acquired by petitioner from the insurance company in 1940, for \$65,000. For each of the fiscal years 1937 and 1939 the petitioner did pay \$600 to Lula M. Minter as interest on the \$10,000 par value of Reclamation District No. 2035 bonds which had been acquired by her. It also paid in each of those years \$18,600 to the Hopkins sisters, that amount being six per cent on \$310,000, which was the amount still owing by Birch and his wife to the said sisters under the agreements of January 10, 1925, and was likewise the face amount of reclamation district bonds still in the hands of the Hopkins sisters.

21. On its books for the fiscal years 1937 and 1939, the taxable years herein, the petitioner accrued \$120,000, to represent interest on the entire \$2,000,000 par value of issued bonds of Reclamation District No. 2035. For the fiscal year 1937, it entered the



\$18,600 paid to the Hopkins sisters, as above stated, as a loan to Birch Securities Company. Birch Securities Company, on its books, treated the receipt of the \$18,600 as a loan from petitioner and charged a net of \$17,382.75 as interest paid to the Hopkins sisters. It claimed a deduction on its income tax return for that year in the latter amount.

22. At no time has any amount been paid into Reclamation District No. 2035, or set aside by Birch and his wife or the petitioner, for the purpose of paying off the bonds of the district, even though the bonds began to mature on January 1, 1935, at the rate of \$227,000 per year.

23. Since its organization the petitioner has operated the Conaway Ranch, devoting it to the growing of crops and the raising of sheep. The petitioner, as owner of the Company Ranch, has borne all of the costs and expenses of maintaining and operating the improvements of Reclamation District No. 2035 and treats such costs as a part of its expenses in operating the ranch, all in a manner which would be no different if there were no reclamation district, whether formal or actual. The district has no expense not taken care of by the petitioner.

24. All crops grown on the ranch during a given fiscal year were sold in the same year in which grown. The herd of sheep was kept at an average of 3,500, with losses being replaced by younger animals. All sales were made for cash, as were all purchases. The petitioner kept a separate set of books with respect to the ranch operations, during the fiscal



years 1937 and 1939. The ranch books were kept on a cash basis. For each of such taxable years Form 1040 F was used in reporting income from the operations of the ranch, and reported the income or loss therefrom on a cash basis.

25. Provided, however, that the respondent, in this proceeding, relating to Docket No. 8720, does not by anything contained herein stipulate or agree that there were issued or outstanding at any time, under any State or Federal laws, any valid or lawfully issued bonds of Reclamation District No. 2035, which were owned or held by A. Otis Birch, or Mrs. A. Otis Birch, or any corporation owned in whole or in part or controlled by them, including the petitioner corporation, or that the petitioner was under any legal liability to pay any "call" or "assessment" for the payment of any amounts of "interest" or "taxes" for which deductions are claimed for Federal tax purposes, and the respondent does not admit that the petitioner did at any time pay any such interest or taxes which constitute allowable tax deductions.

/s/ GEORGE ACRET,  
Counsel for Petitioner.

/s/ CHARLES OLIPHANT,  
ECC.

Chief Counsel, Bureau of Internal Revenue, Counsel  
for Respondent.

Filed T.C.U.S. February 11, 1949.

[Title of Tax Court and Cause.]

ANSWER TO SECOND SUPPLEMENT AND  
AMENDMENT TO PETITION

Comes Now the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the second supplement and amendment to petition filed in this proceeding on February 11, 1949, alleges as follows:

II.

Denies the allegations contained in the second supplement and amendment to petition, paragraph II, page 2.

IX.

Denies the allegations contained in paragraph IX of the second supplement and amendment to petition.

X.

Denies each and every allegation contained in the second supplement and amendment to petition not hereinbefore specifically denied.

Wherefore, it is prayed that the determination of the Commissioner of Internal Revenue be approved.

/s/ CHARLES OLIPHANT,

ECC.

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Division Counsel.

E. C. CROUTER,  
Special Attorney,  
Bureau of Internal Revenue.

Filed T.C.U.S. February 15, 1949.

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The Tax Court of the United States

Docket No. 8720

BIRCH RANCH & OIL COMPANY,  
a corporation,

Petitioner.

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

(Met pursuant to notice.)

Before: Honorable Luther A. Johnson,  
Judge.

Appearances:

GEORGE ACRET,

1210 Quinby Building,  
650 South Grand Avenue,  
Los Angeles, California,

Appearing for the Petitioner.

EARL C. CROUTER,

(Honorable Charles Oliphant,  
Chief Counsel, Bureau of Internal  
Revenue),

Appearing for the Respondent.

### PROCEEDINGS

The Court: The Clerk will call the next case, please.

The Clerk: Docket No. 8720, Birch Ranch & Oil Company.

Mr. Crouter: Ready for the Respondent.

Mr. Acret: Ready for the Petitioner.

The Court: The appearances have been noted, and are Earl Crouter for Respondent and George Acret for the Petitioner.

This case bears rather an old docket number. Hasn't there been some proceedings in this case before?

Mr. Acret: Yes, your Honor. There is a situation here, and it may be of help to the Court if I would make some statements.

Mr. Crouter: If your Honor please, before we proceed with any portion of the hearing, Respondent at this point moves that all witnesses who may be available now or come later be excluded from the hearing room. That is for reasons which I will be glad to explain or argue, if necessary.

The Court: Are there any witnesses in the court room now?

Mr. Acret: Mr. Birch is here, the president of

the Petitioner corporation; Mr. Landrum, the secretary is here It is my understanding the parties to an action have a right to be present—— [3\*]

The Court: Yes.

Mr. Acret: ——as a matter of their interest in the case. However, I don't know, other than their wanting to hear what is going on, I don't know of any reason why they shouldn't be here.

The Court: Do you want them to leave the court room now?

Mr. Crouter: I believe the rule should be invoked at the commencement.

The Court: Any witnesses now in the court room, if they will come forward now, the Clerk will administer the oaths to the witnesses.

Mr. Acret: Mr. Birch and Mr. Landrum.

The Court: Mr. Birch and Mr. Landrum will be sworn now. There are no other witnesses in the court room, as I understand it. The rule having been invoked, the witnesses other than the Petitioner of the case will retire from the court room and not discuss the case or be permitted to discuss it.

Mr. Acret: That means, Mr. Landrum, you are required to wait outside the court room because we can only have one representative of the corporation.

Your Honor, because I believe it would be of some assistance to the Court in a case of this character, I have prepared Petitioner's Trial Memorandum of Points and [4] Authorities, if your Honor would like to have it.

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\* Page numbering stamped at top of page of original Reporter's Transcript.



The Court: I believe it might be well. The Court is entirely unfamiliar with what the issues are. It might be well for counsel of Petitioner to state the nature of the case, the issues involved, and also give the Court the benefit of any information as to what has transpired before in this case.

Mr. Acret: Your Honor, has the Court had an opportunity to read the petition and the amendment to the petition?

The Court: No, the Court is entirely unfamiliar. All he knows is the title of the case.

Mr. Acret: Very well. The petition involved has a sufficient number of ultimate facts that we thought it would be of advantage to have it printed. Your Honor will find it is a printed petition.

The Court: What are the taxable years?

### OPENING STATEMENT ON BEHALF OF THE PETITIONER

By Mr. Acret:

The taxable years involved are 1941 and 1943, originally in the petition, and by reason of the facts that I am about to relate, by reason of action taken by the Commissioner, the issues have changed so that the years involved, strange to relate, and your Honor may be astonished to hear it, first, is the year 1944. It is the Petitioner's [5] right to carry back a loss in 1944, to wipe out the deficiency assessment involved herein for 1943, and the case has a considerable background.

The Court: The Court would like to hear the background.

Mr. Acret: Yes, your Honor. Judge Turner heard a proceeding, Docket No. 109,993, many years ago; 1942, or something like that, involving the principal issues that are involved here, that is, the validity of the creation of a reclamation district in Yolo County, in this State. That is just north of Sacramento, and including the validity of \$2,000,000.00 of reclamation bonds of this Reclamation District 2035, and involving this Petitioner's right to make a deduction of \$120,000.00 a year for payment of amount into the County Treasury sufficient to meet 6 per cent interest on that \$2,000,000.00 of bonds.

Judge Turner made rather voluminous findings of fact, and very accurate ones, in view of the short time of the hearing and the large number of facts which were involved.

The Court: Did that hearing before Judge Turner result in a decision being rendered by him upon that issue?

Mr. Acret: I was about to relate—no, your Honor, the case went on in another manner, that is, Judge Turner, though he made findings of fact in detail with reference to the organization of the District and the issuance [6] of the bonds and the incorporation of this Petitioner and the purposes for which it was incorporated, he decided the matter on a basis of accounting; that is, that the Petitioner was on a cash system of accounting, when, as to the items of deduction involved, they had only approved them;

hadn't paid them, and for that reason, however, he did allow as interest paid certain amounts of those years that the Petitioner had, in fact, paid.

Also, there was involved in that case, and I mention it now because it will have to do with my objection to the materiality of——

The Court: Where is Judge Turner's opinion recorded? Was it a memorandum of opinion or what?

Mr. Acret: It is a detailed opinion. Do you have the citation, Mr. Crouter? I don't have it at hand.

Mr. Crouter: That is a memorandum opinion. It is not a reported case. For the record at this point, we might just state that was in Docket No. ——

The Court: Give the docket number and about when it was.

Mr. Crouter: 109,993, Memorandum of Findings of Fact and Opinion entered April 20, 1944, and that related to the fiscal years ended September 30, 1937, and 1939.

Mr. Acret: That is right.

The Court: What was the next step taken in the case? [7]

Mr. Acret: I was about to call your Honor's attention to the fact in matters that have heretofore been heard in this, that opinion was admitted as Exhibit 2 in this proceeding, and your Honor will find the opinion in the file as Exhibit No. 2.

Now, the next step was that, while I think the matter was pending for decision before Judge Turner, the deficiency assessment that is involved for

1941 and 1943 was made, and this Petitioner filed its petition that is involved herein.

The Court: That is under the present docket number, is it?

Mr. Acet: Yes, your Honor. Then the next thing that happened is that for 1944, the Commissioner made an audit of the Petitioner's books, and filed a report which increased the loss which Petitioner had shown for 1944 from \$84,000.00 to \$186,000.00, and that in that report—and it is Exhibit No.—it is one of the exhibits in this proceeding—I believe it is Exhibit No. 1.

The Court: Those exhibits you refer to, are those attached to a stipulation of facts?

Mr. Acet: No, they are not, your Honor. They were just admitted in a manner I will relate as I come to it in its chronological order.

In that report, which I will refer to as the first [8] report, and it is attached as Exhibit 1 to our amendment to the petition herein, also, it is dated January 23, 1947, the agent in charge stated that "For the history of the taxpayer, see prior agent's report in U. S. Tax Court's findings of fact and opinion herein in Docket No. 109,993." That is the one we have just been talking about. It says, "The additional net loss, as shown in this report, is brought about by the allowance in full of amounts paid by the taxpayer in this fiscal year for assessment taxes on Reclamation District No. 2035. Part of the amount paid in this year covers amounts accrued on the corporation books in prior years, and was disallowed in the prior agent's report, and



deductions, since the corporation was on a cash basis."

Now, in the meantime, along about June, 1947, this matter came up for hearing in this court, before Judge Kern. When it did come up for hearing, as the attorney for the Petitioner, I then stated that in view of this report, we were adopting the contention that we were on a cash basis, and that if we were on a cash basis, that, therefore, the deficiencies that are involved in this proceeding for 1941 and 1943, our position was not well taken because we had only accrued those items and hadn't paid them. We put in evidence the exhibits with Judge Turner. He heard the matter and took it under advisement.

The Court: You mean, Judge Kern? [9]

Mr. Acret: Judge Kern, and took it under advisement, took under advisement the question of whether or not in a proceeding which only involved 1941 and 1943, if this Court had jurisdiction to hear anything concerning 1944, and the validity of that loss. In other words, the loss that was stated in this report that the agent in charge changed from eighty four thousand to a hundred and eighty-six thousand, and he filed, Judge Kern filed an opinion, holding that we were entitled, or that this Court did have jurisdiction to consider 1944, and that we would be entitled to carry back such loss as we might be able to establish.

The Court: What is the date of Judge Kern's opinion?

Mr. Acret: That is sometime in the fall of 1947,



if I remember correctly. Counsel apparently has it. It is the file, I presume.

The Court: All right.

Mr. Acret: Now, in the meantime, your Honor, relying on this first report and the fact we were held to be on a cash basis, the Petitioner paid the amount that is involved herein for 1941, because there was no possibility, there was no right to carry back a loss of '44 for more than two years, so we paid 1941, in the sum of twelve thousand odd dollars, but relying on the right to carry back the 1944, we filed this supplement and amendment to petition, which raises the issues that I am about to relate that are [10] involved here. That is the history leading up to——

The Court: Petitioner's counsel will state what the issues are at this time. Counsel is now ready to proceed for Petitioner concerning the issues now involved?

Mr. Acret: Yes, your Honor. After we made this payment of the 1941 assessment, the Commissioner then caused a reaudit of the Petitioner's books of 1944 to be made, and in that reaudit he disallowed this deduction of interest paid in 1944 to meet the assessment on the bonds, which wiped out the loss entirely for 1944, and that is on the theory that I am about to go into in detail, that this Reclamation District is not a bona fide district, nor the bonds, and that, so to speak, the matter of paying the taxes to the County Treasurer by the Birch Ranch & Oil Company, which owns the land in the District, to the Birch Securities Company, this peti-

tion is like taking the money from the right-hand pocket, so to speak, and putting it in the other.

The Court: In other words, we are now to pass on the Commissioner's disallowance of the payment of those funds, and the validity of those payments. Is that right?

Mr. Acret: Well, there is a little more to it than that, but we now come to the issues raised by this disallowance. This is like all complicated matters; it is capable of being made very clear and simple. It is just a quantity, rather than any difficulty concerning it, and [11] I would like to state at the outset, your Honor, that there isn't a single fact in this case that I think is controvertible or that we shouldn't be able to agree on. What the question of law is going to be, and I think your Honor will see that, even at the close of the opening statement, the question of law is going to be that where a reclamation district is organized by a group of landowners consisting of nine, and one of the landowners makes the improvements himself on a contract with the Reclamation District of a value of \$2,000,000.00, for that \$2,000,000.00 gets a reclamation district warrant in that amount, and where subsequently, after the formation of the district, and five years later, under the provisions of Section 3480 of the Political Code of California, which I will refer to hereafter as the Reclamation Act, those landowners, by a vote, under the provisions of the Act, voted to put a bond issue against the assessment, bond issue against the lands of the District, to pay the assessment of \$2,000,000.00 and where

Mr. Birch, who, with his wife, is the sole owner of this Petitioner and other corporations that I am about to relate, together with two associates of his at the time, traded in their warrant, as provided in law, for the whole \$2,000,000.00 worth of bonds.

They took that in payment for the work they did on the District, and they put in some—I don't know how many—[12] 45 miles of roads and 55 miles of canals, a warehouse site and a levee, and so forth, and the Reclamation Board of the State of California and the trustees of the Reclamation District approved the construction and the cost of construction and the issue of the warrant, and where Mr. Birch, after he got these bonds, purchased out the people known as the Hopkins who owned, I think, approximately a third interest with him and his part of the lands, and used the bonds to pay for that interest, \$786,000.00, and took the bonds at face value.

The law question involved is that whether a District so organized and bonds so issued, whether or not that District and those bonds lose their valid character, if such valid character it ever had, by virtue of Mr. Birch and his successor in interest, this Petitioner, having subsequently acquired all of the parcels of land in the District except one, and having subsequently again acquired all of the bonds. So, it just comes to—it is going to come down to just that plain and simple question of law, when all these facts that ought not to be controverted as before the Court, and the facts I have largely related by stating the question—those facts that I did relate

are contained—I don't know whether this detail is being helpful to your Honor or not, but I think it should help.

The Court: Yes, it is. [13]

Mr. Acret: Otherwise, it would be impossible to estimate the bearing of any of the evidence offered—those facts are contained in Judge Turner's findings. I think that case took three or four cases to present them, though there were many stipulations.

We are going to contend that with respect to the organization of the District, with respect to the issuance of the bonds, the holding of them as found by Judge Turner through a period of years up to and through 1939, the organization of this Petitioner and of the Birch Ranch & Oil Company, the owner of part of the lands in the District, that those facts are *res judicata* in this case. They are the identical—that is an adjudication of the identical principal issues in this case, as far as the basic facts are concerned.

The other case differed in that it concerned the right to make deductions on any accrual basis for 1937 and 1939, as I have stated, whereas this case involved the right to make a deduction for the amounts paid in cash for 1944.

The Court: Are these transactions that you speak of, of Mr. Birch, subsequent to Judge Turner's hearing, or was that involved at the time he found his findings of fact? In other words, what happened affecting the status quo of the parties subsequent to Judge Turner's matter?

Mr. Acret: What happened status quo is that,



as far as this Petitioner is concerned, times got better, and this [14] Petitioner had some money—the Birch Ranch & Oil Company, or rather, the Birch Ranch & Oil Company had some money, the owner of the land, and it was able to pay the taxes each year as they became due, and pay all the taxes to meet the past interest that had accumulated on the bonds.

The Court: Aside from the payment of taxes, what I am wondering about is whether or not the status of the parties, Mr. Birch's rights, as an individual, have they changed any?

Mr. Acret: Not that I can recall in any respect. The rights of this Petitioner changed, however, since the Commissioner filed the first report, and before it filed the second report, because in reliance on the first report, this Petitioner paid the deficiency assessment for 1941, and in reliance, on my advice, that its loss as shown for 1944, be entitled as a matter of law to be carried back to wipe out the 1943, so there is a good basis of an estoppel as well, on which I will have some authorities, and which I have in these points and authorities——

The Court: The matter of estoppel isn't in the pleadings, I guess.

Mr. Acret: No, your Honor, and I am going to have to ask for that. No matter how much we worked—in working on this case as it came up to-day, I found I should have plead both the estoppel and *res judicata*, and I think counsel will [15] not object. I have warned him and talked with him before with regard to this. I think he will not ob-



ject to my filing a second amendment to the petition, setting up the estoppel.

The Court: You don't have such amendment prepared?

Mr. Acret: I will have it over the week end, your Honor. I have been unable to prepare it. As your Honor knows, when we are in active practice, these matters—you get to finally preparing a case just before it is going to trial, and I have been doing that for the last five days, and I haven't been able to get out the amendment.

The Court: Does that conclude the statement of Petitioner's counsel, or do you have anything further?

Mr. Acret: No, it doesn't. There are a few more things I can state, which might be helpful.

Counsel and I, during the past week,—and counsel has been very generous and patient with me in an effort to arrive at a stipulation of facts. He undertook to prepare, and did prepare, a proposed stipulation which is taken from these findings of fact of Judge Turner, and from them he omits certain matters that he doesn't wish to concede, and which is perfectly satisfactory to me to have him omit. I can state that of the first 13 pages he has given to me——

The Court: Let the Court inquire; these matters admitted, you waive those?

Mr. Acret: No, the stipulation provides that either [16] of us may present testimony as to other matters, and we have certified copies of the record with regard to those. For instance, the Superior

Court of Yolo County provided by law, as soon as the Reclamation District was organized, there was a test case to determine the validity of the organization, and the Superior Court so determined.

The Court: The proof upon those matters admitted will be subject to your objections to Judge Turner's decision to hold them binding, or do you concede Respondent is right, Judge Turner's findings do not affect those matters you are going to offer in testimony?

Mr. Acret: Those matters are contained in Judge Turner's findings, the facts I just stated, and they are proper to be stipulated as facts in this case. The stipulation should include them, but we don't mind if they don't, because we can put it in evidence. Do I make myself clear on that? That is the situation.

The Court: I guess so.

Mr. Acret: As I say, I am willing to stipulate as to the first 13 pages, with just one minor exception, a slight inadvertence—slight inadvertent error in there.

Mr. Crouter: If your Honor please, I am very reluctant to make any comment at this time, but I do feel it is incumbent upon me to inform the Court that what Mr. Acret is now referring to is a final draft of a proposed stipulation of facts that he and I went over in considerable detail last week, and it was my understanding that it was agreeable and it was tentatively agreed to bind us. I had our office carefully make the draft, a copy of which he has, but to get to the point, we have not been able to

agree. It has not been agreed to up to this time. I am perfectly glad to have the Court umpire the situation of that sort, if you wish to, or we might do it informally, but we have been unable to agree at all that, and what Mr. Acret is now getting at is just an analysis of taking a part of the prior proceedings and seeing how much we should agree to as facts.

If Mr. Acret has any disposition over the noon recess to go into that matter again, I will be glad to talk to him. I don't think it is a proper matter that your Honor is interested in.

The Court: No, the Court wouldn't be in a position to assist in the stipulation of facts.

Mr. Crouter: It has been well understood, of course, if we cannot agree on those things, they will have to be proven.

The Court: The Court, in the interest of time, hopes they can be agreed to.

Mr. Acret: I think there is no question but what counsel is correct on that; if we can't stipulate, I think that your Honor could help us to do so informally, because it does seem if I can agree on the first three-quarters of what counsel offers, we at least ought to have that much. That is seven-eighths of the case, that first 13 pages, and the only others—the next 5 pages are just matters taken from Judge Turner's opinion, which relate solely to the other case, that is, what was done in the other years, the accrual entries for those years, and so forth, and they are not material to this case. It is the same way with the first two paragraphs——

The Court: It is your contention that the stipu-

lation of facts tendered by Respondent's counsel contain matters that shouldn't be in there?

Mr. Acret: That is right, they contain matters extraneous to the case and related to the other years.

The Court: I hope during the noon recess counsel will see if they can't reconcile the differences about what the contents of the stipulation of facts should be.

Mr. Acret: There are two more matters, and I will have finished my statement.

I believe I should call your Honor's attention to the fact that the only source of error that seems to arise here is by virtue of the interpretation of Mr. Birch's contracts with the Hopkinses, and they would be cleared up by this stipulation, and the other contention, it seems to make the error—it is overlooking the fact that the Reclamation Act [19] provides that a landlord may pay his assessment taxes to the County Treasurer with either bonds, or he may even pay the assessment itself with either bonds or with interest coupons, and the evidence will show that over a period of years Mr. and Mrs. Birch, when they first owned these bonds themselves, or a large part of them, and while they owned the land, they bought coupons from others, other owners of the bonds, and used these interest coupons and turned them into the County Treasurer.

Judge Turner—that is one error contained in his opinion, and it is the error the field officer makes in each occasion, and counsel states that is not a pay-



ment of interest, but Mr. Birch buys the coupons, and under the provisions of the statute, he pays the coupons into pay the taxes for the District. Though it is true he gives the money to an owner of the bonds to get the interest coupons, but the statute so provides, and I wanted to get that in your Honor's mind.

Now, this, over a period of years, was permitted at all times when Mr. and Mrs. Birch owned both the land and the bonds, and the transaction was questioned each time by the Commissioner, because Mr. Birch was in a position to make the deduction for the taxes, and yet, when the interest came back to him from the County Treasurer, it was exempt interest. That is the part that the Commissioner doesn't now [20] like. It is taking money out of one pocket and putting it in the other, and when your Honor analyzes the Act, you will find that between Mr. Birch's right pocket and his left pocket, even when he owned both the bonds and the land it was the law of California and the County Treasurer of Yolo County, and they were all matters beyond the landowner's control and the bondowner's control. It was just the operation of the laws of California, and there is nothing in the law that prohibits the landowner from owning the bonds, and we will show to your Honor that the Reclamation Act expressly permits it, and that is going to be the Petitioner's case.

The Court: Respondent's counsel?



OPENING STATEMENT OF BEHALF OF  
THE RESPONDENT

By Mr. Crouter:

If your Honor please, I would like to make some comment regarding the statutes of the proceeding at this time, and particularly the issues before the Court, and I will refer to some extent to the facts, but, as your Honor realizes, it is a situation where it goes back over the history of a corporation for about 20 years, and I hope I do not make it any more confusing.

To clarify the situation, as we begin, if the Court please, I am afraid the counsel inadvertently made an error in referring to the year 1943, because this proceeding, Birch Ranch & Oil Company, Docket No. 8720, when it was [21] originally filed, related to fiscal years ending September, 1941 and September 30, 1942.

Mr. Acret: I misspoke myself on that.

Mr. Crouter: And there were deficiencies for both of those years in income taxes, which aggregated \$19,749.11, and there were deficiencies determined in declared value excess profits taxes for both years, in the total sum of \$6,252.51.

Now, with respect to the prior proceedings, if your Honor please, and I don't say this to prejudice the record or either side's position, but in a nutshell, as I have read and reread Judge Turner's findings and opinion in the prior case, the question of accounting basis came up, and this same Petitioner corporation, there was accruing a liability payable

to the County on account of these Reclamation bonds, but the amounts were never paid at all, and Judge Turner held under the facts and evidence in that case that the Petitioner was, in fact, on the cash basis of accounting. Therefore, he did not have before him—and it was not necessary to decide this other question of legal liability.

That may help to explain the prior decision, and I would like to say that at page 21——

The Court: Judge Turner's decision merely held that because the payments were not made and the Petitioner was on a cash basis, the accrual of them didn't give the [22] right to deduct?

Mr. Crouter: That is correct, and they were not deductible.

The Court: Is that the only thing you are contending Judge Turner's opinion did hold?

Mr. Crouter: That is all he held precisely.

The Court: In his findings of fact, did he make any findings with reference to these other matters, as counsel for the Petitioner indicated? Do you agree with Petitioner?

Mr. Crouter: Yes, he did, in considerable detail, and most of those findings are included in our proposed stipulation of facts, which I hope we will be able to present after lunch.

Now, in the opinion of Judge Turner, he specifically held, as he stated at page 21 of the mimeographed opinion,—I will not read this paragraph, but he held, in effect, that in view of the conclusion reached and found—I will quote this, “We find it unnecessary to rule on the Petitioner's claim that

the bonds of Reclamation District No. 2035 were and are valid and subsisting obligations, constituting a lien or charge upon the property of the Petitioner, so as to entitle it to deduct so much of the amounts paid thereunder as is allocated to interest."

There is a little more along the same line, but [23] that shows what I want to bring to the Court's attention.

Now, to follow through on the procedural status of this case, there is no intervening proceeding, and there has been no litigation, that I know of, with respect to the fiscal year 1940. Just exactly why, I don't think makes any difference now.

For the years 1941 and 1942, fiscal years, a similar determination was made by the Commissioner, disallowing similar deductions claimed on account of the payment of interest or taxes on these reclamation bonds. That is the proceeding that counsel and your Honor referred to in this same case, Docket No. 8720, and in that case it came on for a hearing before Judge Kern, and——

The Court: When was the hearing before Judge Kern; how long ago?

Mr. Crouter: I have the exact date right in the brief here.

I have a little summary of prior proceedings in the whole case that might be helpful here. This is just a chronological summary of dates.

That was June 30, 1947, the case was presented to Judge Kern. Then on March 24, 1948, memorandum findings of opinion were entered, allowing rehearing, if requested. Now, the basis for that, as I

understand it, is this: You see, the case involves the net loss carry-back provisions of Section 122 [24] of the Code, and only with respect to the year 1942 however. You see, there is a question of a loss in 1944, and as counsel has stated, and I believe most of our evidence here and our attention will be directed to the taxable year 1944, but under the law that could only go back two years, and if established, it might go back to 1942. However, it was conceded in the prior case that it would not extend back to 1941, so, 1941, for all practical purposes, is out of this case, as I see it, although I may say that the decision, that is, the exact decision for the amount of deficiency due has not been entered yet as to 1941. The reason for that, as I understand it, is that only one decision would be entered as to the entire proceedings, and that apparently must await the Court's findings as to 1942.

Now, in 1942, and also in 1941, I believe there were accruals with respect to similar items of interest or taxes as deductions, but inasmuch as it had been held that Petitioner was on the cash basis, the Petitioner did not then reurge the same question which was litigated before. So there is no basis for allowing the deductions we are talking about for the year 1942, and I don't believe counsel will even propose to go into that.

I might also say as to the prior case decided by Judge Turner, it was appealed to the Circuit Court of Appeals for the Ninth Circuit and affirmed on appeal, and [25] certiorari was denied.



We will be glad to establish the official citation in the record at the proper point.

Now, to get down to the state of the case now, the issue before the Court, as I see it, is whether the Petitioner, during its fiscal year ended September 30, 1944, made payments of interest or taxes in the amount either of \$123,666.17, which is the exact amount claimed as taxes, on line 22 of the Petitioner's 1944 return, or whether the Petitioner may be entitled to a larger amount. I believe the Petitioners, in their amended petition, now claim that they are entitled to a deduction of two hundred twenty-one thousand, even or odd dollars, and the Petitioners claim that they did, in fact, make payments then, during the year 1944, to the extent of about two hundred twenty-one thousand, which, together with a great many other facts, of course, establish a net operating loss of the Petitioner for the fiscal year 1944, a large part of which would be carried back to 1942, and thus wipe out the taxable net income on which the deficiency for 1942 is based; so that we are litigating as to the taxable year 1942, but it is the facts as to 1944 which we must necessarily go into.

Now, as to Respondent's position, if the Court please, I do feel it incumbent to say just a few things here. Perhaps first I should clarify the record as to counsel's [26] position.

I might say that the exhibits received by Judge Kern in this proceedings, and that includes one copy of Revenue Agent's report——

The Court: Are those exhibits the ones that Petitioner's counsel referred to in his statement?



Mr. Crouter: Yes.

The Court: They were the ones presented to Judge Kern?

Mr. Crouter: That is correct.

The Court: And they are in the record now?

Mr. Crouter: They were received in the record just to show the fact there was such a controversy. They were not received by the Court, and certainly were not stipulated to or agreed to by counsel for Respondent as final facts in the case.

The Court: And they are not to be received now unless offered again for counsel's position?

Mr. Crouter: That would be my position. I do not agree particularly to the first Revenue Agent's report, because counsel for Petitioner already offered a portion, at least, of the first Revenue Agent's report. There was a later Revenue Agent's report for the same year, 1944, and your Honor will fully understand, I am sure, that while this question of cash basis or accrual basis and the question of [27] allowability or unallowability of these deductions was being litigated before the Tax Court, the Commissioner's position was a little bit uncertain, and it was more or less marking time with respect to later years, to see exactly what position the Respondent should or would take, and in that period of uncertainty, the year 1944 came along, just like other years do. Now, the Petitioner, in the supplement to the petition here—I would like to have Mr. Acret check me on this—as I see it, he has combined certain pages. He has three pages from the first Agent's report as an exhibit to his amended petition, and

then he has taken pages 1, 2 and 4 from the second Agent's report, and he has that as an exhibit to his petition.

Now, the second Agent's report, of course, is the one that the Respondent relies upon in this proceeding, along with the Respondent's own determination here that these deductions are not allowable. This is just one paragraph of the second Agent's report, page 2, which will show your Honor exactly what was determined, among other things that counsel for the Petitioner mentioned. Page 2, "Disallowance is made in the amount of \$21,610.87 claimed as tax deductions for the fiscal year ended September 30, 1944. This amount represents payments to the County Treasurer of Yolo County, California, for the purpose of paying interest on bonds of Reclamation District No. 2035. [28]

"This disallowance is based on the fact that there was no real or actual obligation outstanding against the taxpayer, since Reclamation District No. 2035 was comprised exclusively of the taxpayer's property, and since A. Otis Birch, and his wife, Estelle Birch, the sole stockholders of the Birch Ranch & Oil Company, hold substantially all the bonds of the Reclamation District."

Now, in the amended petition, the Petitioner pleads and relies upon the contrary position asserted in the tax returns. The Respondent in his answer took issue with that; and the answer to that part of the amended petition is just as clear as I believe it could possibly be made, making it very clear in the record that the parties are at issue over an allow-

ability of this two hundred twenty-one thousand dollars. So that the issue is squarely before the Court.

Now, upon that question of two reports and inconsistent positions, I am sure the Court is familiar with a great many cases. Unfortunately, sometimes those situations do arise. Respondent takes the position here that the last report, and certainly the position asserted formally in the pleadings before the Tax Court, represent the Respondent's final determination and his final position in submitting the questions involved to this Court and that the earlier report has been superseded and carries no weight whatever, either [29] as a final determination of any facts that may be involved, and certainly as to any legal question, and I believe this does run finally and chiefly to a legal question of allowability, based upon the California laws and our federal tax laws.

I am afraid that I cannot agree with counsel that all the facts are clear and undisputed. I believe that is evidenced by our difficulty in getting together, but we will still try to do that. Some facts are not agreed upon, if the Court please, particularly with respect to the organization of a Reclamation District by several persons dealing at arms' length, and for real business purposes. I will refer to things along that line a little later, but I do want to refer to two other issues before I get lost in the facts here.

With respect to two other matters that counsel mentioned, the question of *res judicata* and the question of estoppel; neither one of those has been plead in this proceeding up to this time, if the Court please. Now, it is true that counsel did mention to me as

long ago as a week or so ago that he might contend that prior proceeding is *res judicata*. My position at this time, if the Court please, and I have given a good deal of thought to this before this time and since counsel made his statement this morning, is that those are not issues in this case. I may say briefly that [30] particularly in view of Judge Turner's precise findings and holdings, I don't see how the plea of *res judicata* could have any merit. As to estoppel, Respondent's position is that—there is really no merit in that, either. The Courts have held many times the Commissioner is not estopped by a prior agent's report; there can be no estoppel, as I see it, as to the year 1941, because there is no possible carry-back to that year. There was no payment of taxes in that year. As I understand it, there was no payment of taxes in 1943 which could be carried back to 1941, so it is impossible for me to conceive what the Petitioner might rely upon for estoppel at this point.

The Court: Your position on that, however, would not be precluded in the right to plead estoppel?

Mr. Crouter: I was coming to that, if the Court please. We have had a great deal of difficulty with this case, as shown by our proceedings here. I believe that if those matters are seriously urged by the Petitioner, they should be reduced to writing. We should have them at the very commencement of the case, and at this point, although I am very reluctant to, I have to strongly object to any further inclusion of issues in the case. That is the reason it was



continued over and Judge Kern went into it. There was a question of whether the operating loss had been sufficiently pleaded in the case. As your Honor has probably discovered in [31] other cases, if it is an issue in the proceedings, then it must be determined in the proceedings. If a carry-back loss is not involved in the proceeding, the pleadings, then it can be litigated and determined later. So Judge Kern very fairly, and Respondent was in agreement with that, held the record open so that that question could be pleaded, so that the parties would know where we stand, go from there, and finally get to grips with this basic issue.

With respect to estoppel and res judicata, if the Court please, there are tremendous records connected with this case, in spite of what I have on my table, this is just a small portion of them, and I am not prepared at this time to go back into all of the prior cases and every element of estoppel. A number of agents worked on the case at different years, and some are out of the service now. I would have to make a round-up of witnesses, if counsel is really going into these issues. I don't think they are proper issues in the case, and I would like to have that question first determined by the Court, and my position would be that if counsel is serious on them and feels that should be included in the case, I am not disposed to deprive them of a chance to litigate anything they want to litigate in this proceeding, if it has any bearing, but I would have to ask that the hearing of the case be further continued so we can



have those matters in writing and know exactly what they contend. [32]

The Court: I think the suggestion that the pleadings be reduced to writing is a sound one. I think we frequently make a mistake by granting permission to amend without it being reduced to writing, but I do think Petitioner would have the right, should have the right to plead *res judicata* and estoppel, whether the Court might determine there was any merit in it or not, but suppose the counsel for Petitioner be given until we reconvene this afternoon to reduce those issues to writing, that is, *res judicata* and estoppel, and then counsel, of course, for Respondent would doubtless deny those. I don't know. There would be no affirmative pleadings.

Mr. Crouter: There would be a denial. As to the question of proof, *res judicata*, particularly, as I understand it, does involve everything that was previously submitted to the Court in the prior proceeding.

The Court: Wouldn't the record in the other case determine what was submitted to the Court in the prior proceeding?

Mr. Crouter: In a general way, if the Court please, but there are exhibits and testimony and things of that sort, and I do not have them. I will take oath and go on the stand, if your Honor wishes. I do not have everything involved in the prior case, and some things I want to examine. Your Honor is familiar with our system of closing cases year [33] by year and sending files back to Washington. I do not have all the prior documents and papers relat-

ing to the prior case, because I thought that 1937 and 1939 were certainly out of this case. I do have some of those, but I am afraid if broad allegations are made under *res judicata* and also under *estoppel*, I am afraid I would need further documents, and the Respondent would be seriously prejudiced by being in a position where he could not offer any evidence or having then to ask the Court to hold the record open and hear the rest of it at another calendar or in Washington. I would like to see it all brought together at one time and place and disposed of.

The Court: It is almost 12:30 now. Did you conclude your statement about the case? Let's leave that open right now. I am going to suggest that during the recess at the noon hour the Petitioner reduce to writing his pleadings on those issues, that is, *res judicata* and *estoppel*, and then we can take up at that time whether or not that would necessitate a postponement of the case.

Mr. Crouter: Does your Honor care to hear as to Respondent's position on the matters?

The Court: Yes, I was just indicating so that counsel will know.

Mr. Acet: With respect to that, I would like to state, your Honor, there is not any change in issues here in [34] the original petition. We alleged certain losses for 1944, and asked to be allowed to carry them back, but then when the Commissioner took the position we were on a cash basis, it made those losses different, and that is the basis of this amendment to the complaint.

Now, in the amendment——

The Court: We can discuss that when the pleadings are presented.

Mr. Acret: Yes, your Honor, but in the amendment to the complaint we allege and set forth Judge Turner's opinion, and, by the way, your Honor, it was admitted unconditionally in this proceeding, and I contend that this proceeding is merely a further hearing of Judge Kern's proceeding, and that the document is in evidence, the findings of fact, what they are, and there are no new facts to be alleged, and all we need to do—and I proposed it to counsel—at the end of the second paragraph is to insert the legal conclusions. That is all we need to do.

The Court: In the meantime, counsel will do that and then after we reconvene we will take up the question of the effect of the pleadings.

Mr. Acret: I was proposing to just ask leave to insert the words, "that such decision is res judicata of such."

The Court: Are you ready now to amend your pleadings? [35]

Mr. Acret: Yes, your Honor, just by interlineation.

The Court: You can do it right now and submit it to counsel.

Mr. Acret: It is to interline at line, the third line on page 2, at the end of the paragraph, the words, "that such decision is res judicata of such issues here." That is all that is necessary. Then to

add a paragraph, and I will draw that up and ask to insert that by interlineation, "That subsequent to such filing of such second report—" I am not following the wording closely here now—"the Petitioner, in reliance thereon, paid said deficiency assessment for 1941, and the Commissioner should be estopped from asserting facts against this Petitioner different from those therein contained."

The Court: Counsel can have that prepared by the time we reconvene at 2:00 o'clock, and counsel for Respondent can now conclude his statement on the merits.

We understand the amended pleadings will be taken up at 2:00 o'clock and I would like for Petitioner's counsel to have that amendment ready in writing.

Mr. Acet: Yes, your Honor.

Mr. Crouter: With respect to the merits of the question of deduction of interest or taxes for the year 1944, if the Court please, the Respondent's position is that no deduction is allowed, or are allowable in accordance with [36] the determination and this last report, for various reasons. There are several, and there is a little overlapping, but I might just in a general way mention them so the Court will know Respondent's position as we go along with the evidence.

The basic one is that Respondent contends that there was no Reclamation District ever organized, and that there were no bonds ever issued and outstanding during any of the taxable years involved here upon which such deductions could properly be



recognized. This, of course, goes back to the formation of the District and the number of people in it. The basic reason there is, as the evidence will show, the Petitioner corporation acquired ranch property that was previously owned by the Petitioner and certain other persons, mostly very close relatives. The evidence will show that there was certain reclamation work done, about two million dollars, or a little over that, but the money was all advanced and the work was done by Mr. Birch or Mr. Birch's corporations; that the others may have contributed something, but a very small portion of it. I believe that from the beginning the evidence will show that there was some disagreement between some contiguous landowners and certain ones dropped right from the start and were not in it.

Just to stick to the legal questions, Respondent's contention is that there was no original issuance of bonds; that is, back in about 1925, I think. [37]

Now, it is a long story and we will all have to have some patience. There were bonds that they claim were issued which are affected here, and they were 10-year bonds. They were all to be paid off in 10 years. I think the face amount was \$227,000.00 for each one over a 10-year period, and they contemplated apparently that \$2,227,000.00 would be paid back, and all of the liens and everything wiped out and erased by that 10 year period, by the expiration of it, in other words, about 1935.

It is my understanding that the Petitioner contends that there was a reissuance or a refunding of some kind of bonds about 1935, and that is one of



the points particularly on which the facts will have to be secured, and the Respondent has never been shown, much less convinced, that there was, in fact, a real reissuance of bonds at that point, about 1935, which is, of course, prior to all the taxable years on which the Petitioner could pay any amounts as taxes or interest, which would be recognized as such.

So Respondent asks for proof on the issuance of those bonds and the original formation of the Reclamation District, insofar as it involves the question of a taxpayer and his own solely owned corporation dealing with and among themselves in the organization of a district like that, and the setting up and claiming of tax deductions.

The evidence will show the Court and the facts, I think [38] will be clear on this, that at first there were accruals of liability, and the corporation would take a deduction. The corporation, of course, owned the land, and there were assessments on the land, and then the bonds were issued and outstanding, and Mr. Birch and some other persons held some of those bonds.

Moneys would be paid to the County Treasurer at 6 per cent on the \$2,000,000.00; that makes \$120,000.00 each year, and the corporation for some years would accrue the liability and taking a deduction of \$120,000.00 each year. That, of course, was claimed as a federal tax deduction.

Now, the way this operated, if the Court please, and I think the facts will be clear on this part of it, was that usually contemporaneously with a payment to the County Treasurer, who was, under the statute,

a party to such a Reclamation District, payments would go into the County Treasury from the corporation, and payments would go from the Treasurer back to the individual, as interest. Now, that was interest on the bonds which were held by the individuals, held and owned by them, and that under the procedure set up, it was received as tax exempt interest, so that the Petitioner—not the Petitioner, but Mr. Otis Birch and his wife individually did not ever report taxes on the interest received from the County and through this system. [39]

Now, that apparently was set up and operated a great deal. If we have to go into the whole history of this thing, I believe the evidence will show that more than \$2,000,000.00 went into the County Treasurer's office as a payment of interest; more than \$2,000,000.00 came out of the Treasurer's office as tax exempt interest. I believe that the record will show that this Petitioner was organized and operated ranch properties, including several sections of good farming land, and so forth, and that over a period of 20 years it never paid one dollar of federal tax to the Federal Government, under this system as it operated.

The Court: The only parties before the Court now is the corporation, as I understand it?

Mr. Crouter: That is correct. If the Court please, the Respondent contends that this whole Reclamation District, and that this system of making payments allegedly of taxes or interest to the Reclamation District and the taking money out, that was

just a fiction, it having no real substance that should be controlling for federal tax purposes.

Now, I don't believe it is altogether controlling, whether the Court finds ultimately there was or was not a valid Reclamation District to begin with. The situation 'way back in 1918 and 1920, when it started off, was vastly different, and the interests were vastly different from what they were a few years later and long before 1935. Those [40] first bonds apparently expired by their terms, and the State laws will have a bearing on this. We will show to the Court during the proceedings, or on brief, that bonds are supposed to be paid off, and when they are not paid off and in default, it is the duty of the State officials to foreclose on the property and take it. That never happened in this case. As a matter of fact, the evidence will show that during the depression years a great many years went by and there was no payment to the County Treasurer and there was no payment from the County Treasurer, because money apparently was not available, and the whole thing was more or less abandoned.

Now the Respondent contends that the corporate entity here should be ignored. The evidence will clearly show, as counsel stated in Petitioner's opening statement, that the petitioning corporation was wholly owned by Mr. and Mrs. Birch, if not directly through one of their holding corporations. I believe it was through another corporation during most, if not all, of that time, but regardless of whether there is only one corporation or two corporations, that is essentially Mr. and Mrs. Birch.

Respondent relies upon certain decided cases, but I will not mention those. There is a prior case of the Board of Tax Appeals involving the question of income or loss as between certain corporations in a Bond District, and that is the Rindge Land & Navigation Company case, 2 B.T.A., 1179, and [41] various other authorities that the Respondent will rely upon.

Respondent, among other things, relies upon another contention, and that is that under California law, under General Real Estate Law, and under the facts which will be shown here, there was a merger of all interests and titles and holdings of Mr. Birch in himself or for himself and this corporation, so that any liens on the property and obligations on the property were merged with the ownership itself; so that Mr. Birch was really, in fact, going through the form of paying from one pocket to the other; that deductions, of course, are a matter of statute, and that is, this is not a case of any real tax or any real interest that should be recognized for tax purposes.

Respondent further contends this was not a part of any real business, of a business corporation, but it was a peculiar arrangement which certainly had its tax advantages, if it would stand up, but it should not be recognized and certainly was not contemplated either under the original Reclamation Act of the State or the Revenue Act.

Now, as to the revenue acts, the Court is familiar, of course, with the provisions of Section 23 B. of the Internal Revenue Code, and the Court will recall



—with the Court's permission, I would like to read it:

“Interest—All interest paid or accrued within the taxable year on indebtedness, except on this indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this chapter.”

Now, you see, that says interest generally is deductible on this indebtedness. Respondent will contend that under this statute and under the decisions based upon this statute, we have here in this case the very simple situation of a system and mechanics set up and followed to create this tax exempt interest, so that any expense or any disbursements made in connection with that is not to be recognized as an interest payment for the additional reason that it is merely a part of the securing of tax exempt interests.

I should also like to state, if the Court please, that Respondent directly contends that the continuation of this system of havings bonds outstanding, of never retiring the principal but leaving it outstanding—and I may say that, as I understand it, Petitioner will attempt to show that in about 1935 in connection with their refunding, they not only extended it for 10 years, but extended it clear through 1984, so, you see, this is a basic question we might as well have determined, so we don't have to litigate every year before 1984.



The Respondent contends this is just a tax [43] avoidance arrangement, and I say that respectfully, with no discourtesy to Mr. Birch. He has attempted to do what he thought he could do legally, but it has never been done either in this petition or any other.

The Court: Have you been able to find anything on the question of merger?

Mr. Crouter: There are State decisions, and I will be glad to cover that in the brief.

The final point, the carry-back statute also has certain exceptions and limitations, and there, of course, any loss incurred must be incurred in connection with regular business operations.

Respondent will contend in brief, I believe, that whatever may have happened in 1944, it was not a regular part of ranch or oil operations, and even under the carryback statutes, Section 122 of the Code, the facts will not establish a loss which could be carried back to wipe out any deficiency which the Commissioner has determined for the year 1942.

Thank you very much.

Mr. Acret: Just one position that the Petitioner takes, and for me to convey that to your Honor may be helpful at this time, and I overlooked stating in and will answer counsel.

He brings the crux of the situation down to [44] whether or not a person has a right to own a lot of land and bonds on it, and deduct the interest and receive back the interest as exempt.

As I say, the Commissioner permitted Mr. and Mrs. Birch to do that for years, and under the laws of the State of California, it expressly provided the

exempt interest for the purpose of encouraging men like Mr. Birch to do this very thing. In other words, he went in and spent \$2,000,000.00 under the provisions of the Reclamation Act and the laws of the State of California on land no good, developing swamp and marginal lands on the basis he could do this or otherwise he wouldn't do it. He took lands absolutely worthless and spent \$2,000,000.00 on them, because you can put bonds on them, with the ultimate idea he possibly could, if he wanted to, put bonds on them and have it as exempt interest.

I have cases in my memorandum that say the purpose of the law is even to "coerce," using the expression, in the development of these marginal lands. When the State of California has tried to do this, the government has tried to take away the benefits.

Insofar as not paying the first bond issue, lots of people couldn't pay the bonds in the depression period. When I was in Washington—I don't know the situation here—but lots of property owners couldn't pay, but the government extended our chances and was lenient with us during the [45] depression. This company paid as soon as it could, and paid all the interest up to date, but couldn't do it before.

Does your Honor want me to hand one of these to the Clerk, these Points and Authorities, which shows opposition with respect to the provisions of the Reclamation Statutes. Your Honor, this is going to be decided by you, I am sure, solely on the provisions of the Reclamation Statute of California.

The Court: I think that would probably come a little later, wouldn't it? Is that the extent of the legal authorities sustaining your position?

Mr. Acret: Rather a statement of our position and the authorities supporting it.

The Court: We are going to take a recess until 2:00 o'clock, and at that time the Court would like counsel for Petitioner to have formally prepared and presented his plea upon those two issues, and counsel for Respondent will then be heard and Petitioner, also, upon that issue.

We will take a recess until 2:00 o'clock.

(Whereupon, at 12:45 p.m., a recess was taken until 2:00 p.m. of the same day.) [46]

### Afternoon Session

The Court: Is counsel ready to proceed in the case?

Mr. Crouter: I believe so, if the Court please.

Mr. Acret: Yes, your Honor. May I proceed?

The Court: Yes.

Mr. Acret: At this time, your Honor, I present to the Court the proposed amendment.

The Court: An amendment to Petitioner's amendment?

Mr. Acret: A supplement and amendment to the petition, which consists of the insertion on Page 2 at the end of line three, the following words, "That such findings of fact are res judicata of such issues herein," and the insertion, at Page 5, after paragraph eight, to wit, the last paragraph thereof, the

following: "That subsequent to the filing of the report referred to in paragraph three hereof, and in reliance upon the position taken by the Commissioner in such report in the respects of foresaid, this Petitioner did, on July 7, 1947, pay to the Commissioner in full the deficiency assessment involved herein for the year 1941, together with interest thereon, to wit, the sum of \$12,398.85; that by reason of the facts alleged herein, Respondent ought to be and is estopped from changing his position herein with respect to this Petitioner having suffered such loss in 1944 and with respect to this Petitioner's right to make such deductions of \$120,000.00 for such year for taxes paid by it to enable such [47] reclamation district to meet interest for such amount in such year upon such bonds."

That is the amendment, your Honor, and I have handed to the clerk a page stating those insertions and where they would go, and she proposes to insert them in the file in the appropriate place.

The Court: The amendment will be received and filed as a part of Petitioner's pleadings in the case.

Does Respondent desire to make any reply to the amended pleadings?

Mr. Crouter: I would like to make a written denial, if the Court please. I would like to have permission to file a written denial of the allegations made, but I am ready to proceed.

The Court: That permission is granted.

Mr. Crouter: I would like to observe and just call to the Court's attention that as to the estoppel question in the year 1941, that year, of course, is directly



at issue in this proceeding. It is true there have been prior proceedings on it, but it is still the same year that is involved in the case before the Court, and if the Petitioner had any position that it wished to save or assert in this proceeding, it is still open, so that does not go beyond the very years before the Court here.

Mr. Acret: We made some statements when Judge Kern [48] conducted the hearing, stating that we abandoned the allegations and claim in our petition with reference to 1941. I forget just how it was worded, but he just stated it would be noted in the record, or something to that effect. It is understood we not only abandon the position taken with reference to 1941, but we have since paid the amount involved, with interest. At this time, your Honor, I presume we present jointly the stipulation of facts for filing herein, which, I believe, your Honor has read.

The Court: The stipulation of facts will be received and filed as part of the record in the case.

Mr. Acret: At this time we offer in evidence receipt of the collector of internal revenue, dated July 7, 1947, for said sum of \$12,398.85 for the payment of said deficiency assessment for the year ending September 30, 1941.

Mr. Crouter: No objection.

The Court: It will be admitted as Petitioner's Exhibit No. 1.

Mr. Acret: May it be number 4, your Honor; there are three already numbered.



The Court: They haven't been formally presented, have they?

Mr. Acret: I will, if your Honor please.

The Court: Present those first.

Mr. Crouter: There are numbered exhibits in [49] connection with the prior hearing in the same case.

Mr. Acret: I will re-present them, then.

The Court: I think you had better re-present them. There are no exhibits contained in the stipulation, as I recall.

Mr. Acret: No, your Honor.

Mr. Crouter: That is correct.

Mr. Acret: At this time, in support of the pleadings, relative to *res judicata* and *estoppel*, and for all purposes, the Petitioner offers, reoffers for re-admission Exhibit No. 1, which was heretofore admitted as such Exhibit No. 1 in the prior proceedings in this matter.

The Court: What is the document? Identify it by some name that will indicate what it is.

Mr. Acret: Exhibit No. 1, the Reporter's transcript shows it to be a 30-day letter of the internal revenue agent in charge, dated January 22nd, it seems to be, with three pages attached. The Exhibits ought to be in the file, should they not, bound in?

The Court: That was Exhibit 1 in the hearing before Judge Turner or before Judge Kern or both?

Mr. Acret: Before Judge Kern.

The Court: Does the clerk have those Exhibits in the record here, filed?

The Clerk: They are not in the file. [50]

Mr. Acret: Your Honor, the Exhibits must be separate from the file.

The Clerk: They don't usually clip them in the file.

Mr. Acret: As I understand it, and from this record, it appears there is an inadvertent misstatement on my part as to the year. The Exhibit 1 should be the first report of the internal revenue agent in this matter.

The Court: What date is that?

Mr. Acret: I don't have the date of it. The first page is gone.

The Court: Is the document there? It might have been introduced before and not now contained in the record of the file. The clerk wants to mark them as being introduced.

Mr. Acret: They should be with the file. If they are not here, they can't be reintroduced. Would counsel supply me with a copy of the first report?

Mr. Crouter: I don't believe I have a copy of that Exhibit that went in evidence.

Mr. Acret: Well, counsel has a copy of the first report that contains the allowance of the deductions. It fixes the loss in the amount of \$221,000.00.

Mr. Crouter: To answer the Court's question a while back, the Petitioner has attached to his first amendment to the petition what appears to be the transmittal letter with that first report, and that is dated January 3, 1947. Now, [51] if your Honor please, I would like to say, as to this matter, that I would have to object to that first revenue agent's report going into evidence, for the usual grounds that

the Respondent objects in such cases, and that is that it has been superseded, that it is not evidence of any fact or alleged fact or statement contained therein, and that it is not binding upon the Commission, particularly when the Commissioner and a different agent at a later date have made a different and contrary finding and determination. I would say, however, I have no disposition to keep that out of this record, insofar as it was received before. I would like to explain to the Court that at the proceedings before Judge Kern, on June 30, 1947, as shown at page 41 of the transcript, at that time the Court ruled upon this very matter and received that report on a conditional basis as to the 1944 loss, and the Court stated: "I understand the revenue agent's letter to which counsel refers will not be submitted as proof to any of the facts set out therein or the existence of the losses referred to, but merely to prove that at the present time there has been an official recognition on the part of Respondent there may be a net loss allowed in 1940."

"Mr. Acret: That is it exactly. Further than that, counsel doesn't need to worry. We are conceding the matter may be left open. We are conceding it isn't any decision on the merits." [53]

So, it seems to me that shows the report is in the record for whatever it is worth.

Mr. Acret: This is offered. We are setting this up as an estoppel, because since Judge Kern's ruling, we have done something; paid \$12,000.00.

The Court: The Court will admit it for all purposes, and the effect will be given later.

Mr. Acet: Very well. I haven't the transmittal page that goes with it, but I have here the two inside pages that contain the matter that shows the position taken by the Commissioner in his letter of the date stated by counsel. That is a preliminary statement that says, "For the history of the taxpayer, see a prior agent's report in U. S. Tax Court findings of fact and opinion in No. 109,993," and then in that they show how they changed the loss we took for 1944 from eighty-four thousand to a hundred and eighty-six thousand dollars, by reason of allowing us this deduction of the money paid as taxes.

The Court: What counsel just stated, is that contained in Exhibit or is that something additional?

Mr. Acet: This is two pages of the Exhibit, for your Honor's present information.

The Court: The Court wants to be sure that the Exhibit speaks for itself, and that it is received and marked by the clerk so we may know it is a part of the record in this [53] case.

Mr. Crouter: May I inquire, are those pages two and three from the first agent's report or the second?

Mr. Acet: The first agent's report.

Mr. Crouter: I wouldn't object to that. If the other complete report is in the record, I think that would be enough. I have no objection to counsel showing that to the Court for his information as we proceed here, but I don't see this needs to be offered or received in the record, and I object to anything



contained in it, on the same grounds I objected to the other one.

The Court: The Exhibit hasn't been located yet.

Mr. Acret: Your Honor, it was put in.

The Court: I mean, it is not here. The Court wants to know if the Exhibit is here now.

Mr. Acret: Apparently not, but I have a photostatic copy of two pages.

The Court: Why can't we submit the photostatic copy if we know it to be correct, because it may be lost or misplaced. When the Court goes to determine this case, he wants to be sure the evidence offered is available.

Mr. Crouter: It seems to me counsel should furnish a complete report.

The Court: I think the whole document should be offered. [54]

Mr. Acret: I put it in evidence, your Honor, and put it out of my power to do anything further with it, except insofar as I may happen to have a photostatic copy.

The Court: Does counsel agree that is a correct photostatic copy?

Mr. Crouter: It appears to be, the first four pages, at least. I am not able to tell whether that is all of it, but that is the first three pages, with the transmittal letter.

Mr. Acret: We offer the four pages in question, your Honor, photostatic copies.

Mr. Crouter: To which Respondent would like to have the objection on record, if the Court please, that this is a first revenue agent's report, which has been entirely superseded by a later agent's report,



a copy of which has been made a part of the Petitioner's amended and supplemental petition, and on the ground that this first agent's report is inconsistent with the Commissioner's determination in this case; it is inconsistent with the Respondent's present position in this case and any matters or conclusions or alleged admissions contained therein are not binding upon the Respondent.

Mr. Acret: It is understood it is offered as the basis of our having paid the \$12,000.00.

The Court: The effect to be given the testimony will be determined. It may not be given any effect, but it will be admitted, subject to the objection of Respondent's counsel, [55] and he has his exceptions on the grounds stated. Now, that photostatic copy is admitted in lieu of the original, unless the original can be found.

Mr. Acret: Very well, your Honor.

The Court: The clerk has that now?

The Clerk: I am going to mark it Exhibit 1.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 1.)

Mr. Acret: At this time we offer by reference the findings of fact of this Court in Docket No. 109,993, which were admitted as Exhibit No. 2, generally admitted, in this matter, in the former proceeding.

The Court: What is that document?

Mr. Acret: That is the findings of fact of Judge Turner in 109,993.

Mr. Crouter: If your Honor please, Respondent

very respectfully objects to the receipt of this document as a summary or complete statement of the facts in the case, for the following reasons: The matters contained in the findings there, of course, do have some bearing upon the matters which are involved here, but I don't fully understand counsel's position in that regard, because the stipulation of facts which we have entered into contains verbatim paragraph after paragraph, at least nine-tenths, I believe, of the findings of Judge Turner in the prior memorandum opinion, and that is [56] exactly what most of our findings are based upon. In a general way, the things that are in the findings that are not in the agreed statement of facts, in my opinion, and with all due respect and deference to Judge Turner, are things in the nature of conclusions as to the validity of certain proceedings or invalidity of them, and things of that character, which appeared to me to be conclusions.

Now, counsel has offered as evidence things of that character which he has deleted from the stipulation of facts. I did not know he was going to turn around and offer that as such, and I object. I do not believe the matters contained in these constitute facts and should not be received by the Court in this proceeding. I am inclined to think Judge Turner would rule that way.

Mr. Acret: I think this is admissible for two reasons; in the first place, it is in evidence generally as Exhibit 2. I offered it generally. I stated, "At this time we offer the findings of fact to the Tax Court in Docket 109,993——"

The Court: What are you reading from?

Mr. Acret: Page 43 of the Reporter's transcript of the proceedings in this matter, which took place June 30, 1947, before Judge Kern. Counsel made objection. After two or three pages of argument, the Court stated, "Well, I think that will have to go in one way or another for one purpose or another." The [57] Court said, "I will overrule the objection and it will be admitted in evidence."

So, it is in evidence as No. 2.

Further than that, No. 1, which has just gone in, being the report of the Commission, states that "For the history of the taxpayer, see prior agent's report in United States Tax Court findings and opinion in 109,993," and that is the findings of opinion, and it is necessary to have that to connect this up.

Also, the third reason is that it is admissible now, and I am offering it again for the reason that there is since intervened a new issue, and that is that those findings of fact are *res judicata*, and we offer them in support of that issue.

Mr. Crouter: If your Honor please, I do not wish to be contentious about this matter, but I again have to refer to the proceedings before Judge Kern on June 30, 1947, a transcript of which, I take it, would be with the Court's file, and the same document was offered at the hearing before Judge Kern, and the Court inquired whether there was objection and I made objection somewhat along the same lines that I have objected here, and perhaps some additional grounds, and then the Court stated, at page 44: "I question how important any of those facts

contained in the memorandum and opinion and findings are in this case. Ultimately the question I have is a procedural question.” [58]

If I may just interpolate, the Judge was still there concerned as to whether the net loss carryback was an issue in the case. Now, omitting some of the colloquy, on page 45, I made the further statement:

“Mr. Crouter: I have no objection to that going in merely for the Court’s information, and for consideration in making its ruling an order with respect to the net loss carryback question. I do not concede all the matters stated there are facts, and I do not wish to have the Commissioner prejudiced in any future proceedings of that kind in Court or out with respect to anything I do now regarding this statement.

“The Court: Well, I think that will have to go in in one way or another, for one purpose or another, that finding of Judge Turner.

“Mr. Crouter: Yes.

“Mr. Acret: Whatever the legal effect of that is is another matter. That results just as a matter of law.

“The Court: I will overrule the objection and it will be admitted in evidence.”

Then it was received in evidence, as shown at page 45. I submit it was not received for all purposes before, and I think Judge Kern recognized—— [59]

The Court: Well, there has got to be a lot of unscrambling done here in reference to what has gone before. In order to do that intelligently, and without



making any commitment, I think it should be admitted. I will overrule the objection. That will be admitted as Petitioner's Exhibit No. 2. Does the Clerk have the Exhibit there?

The Clerk: No.

Mr. Acret: That can be No. 2 by reference, and the record will show that. That was in a memorandum opinion, was it?

Mr. Crouter: That is right.

The Court: What is the number of the memorandum opinion?

Mr. Acret: 109,993.

The Court: Have the Clerk indicate there the document number and the date of the memorandum opinion.

The Clerk: That was a finding of fact of Judge Turner?

Mr. Acret: 109,993.

The Court: And entered when? Does counsel have that date?

Mr. Crouter: My file indicates that was entered April 20, 1944. If the Court please, may Respondent have an exception on the rulings on Exhibits 1 and 2, if that is necessary? [60]

The Court: Yes. That is Exhibit 2.

(The document above referred to was received by reference as Petitioner's Exhibit No. 2.)

The Court: Now, what is Exhibit 3?

Mr. Acret: Your Honor, we reoffer in evidence Exhibit 3 in the formal proceedings herein, which is Petitioner's income tax return for the year ending



1944. Does counsel want to put in, furnish the original of that?

Mr. Crouter: Yes, Respondent would be glad at this time to offer the original.

Mr. Acret: I was just going to take it as our Exhibit 3.

Mr. Crouter: It is necessary for Respondent to keep an exhibit number. We can make it a joint exhibit.

The Court: Joint Exhibit 3-A.

Mr. Crouter: And that will be the original of the income and declared value, excess profits tax return, Form 1120, of Birch Ranch & Oil Company, the Petitioner herein, which was filed in the Sixth California Collection District.

Mr. Acret: For the year ending September 30, 1944.

The Court: Fiscal year ending September 30, 1944. That will be admitted as Joint Exhibit 3-A, and leave will be granted to substitute photostatic copies.

(The document above referred to was received in evidence and marked Joint Exhibit 3-A.) [61]

Mr. Acret: May it be stipulated here, counsel, before I forget it, in case it isn't in our stipulation, that counsel's system of accounting is at all times material on the basis of a fiscal year ending September 30th.

Mr. Crouter: That is correct, and I so stipulate it.

The Court: On a cash accrual basis?

Mr. Acret: We are adopting, on account of the reports, a cash basis. We are consenting to it in this instance. It makes no difference whether it is accrual or cash, because the only item involved, we paid. Another thing, so there will be no misunderstanding, counsel made it clear to your Honor, I think, but if we are not entitled to the hundred and twenty thousand dollar deduction, we will owe the deficiency for 1942. In other words, it takes at least about \$14,000.00 to be able to carry back out of a hundred and twenty thousand dollar deduction, or we are not entitled to anything.

Mr. Crouter: I believe that is a fine thing to stipulate. There are no other issues or matters relating to the fiscal year 1942, which are left open or still pending or as to which the parties are at issue. In other words, as to the year 1942, it is closed, except the one question of a carryback loss from the fiscal year 1944 to the fiscal year 1942.

The Court: Does Petitioner's counsel agree to that stipulation? [62]

Mr. Acret: Yes, and I bring that up because I think it would reduce your Honor's labor, if you could make some kind of a note.

The Court: The record will show that.

Mr. Acret: At this time we offer Exhibit 4, which is the receipt.

The Court: That is what you started to offer a while ago?

Mr. Acret: I have shown it to counsel.

Mr. Crouter: No objection.

The Court: State again what that is.

Mr. Acret: A receipt of the Collector of Internal Revenue, dated July 7, 1947, for payment of \$12,-398.85. It says, "For fiscal year 9-30-41."

The Court: And that is a payment made by the Petitioner in this case?

Mr. Acret: The receipt runs to Birch Ranch & Oil Company, the Petitioner herein.

The Court: It will be received as Petitioner's Exhibit No. 4.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 4.)

Mr. Acret: Further than that, your Honor, to clarify the record, that relates to the deficiency assessment involved herein for the year 1941, which this Petitioner—concerning [63] which this Petitioner heretofore abandoned.

If your Honor please, I will take some of the matters which counsel didn't or for which some reason we didn't include in the stipulation, and I am showing counsel now three exhibits.

Mr. Crouter: Respondent has no objection to these documents going in evidence in this proceeding, if the Court please. I wish to state, however, that we do not concede everything contained in the documents.

The Court: You refer to the three documents that Petitioner's counsel is now about to offer in evidence?

Mr. Crouter: That is correct, if the Court please. We do not agree as to any conclusions shown on the

documents or conclusions Petitioner may draw from them, but they are documents which have some bearing upon the issues.

The Court: They will be offered now as Petitioner's Exhibits.

Mr. Acet: I will state what they are.

The Court: The first will be Exhibit No. 5, and what is that?

Mr. Acet: At this time the Petitioner offers a document to be marked Exhibit No. 5 herein, which was heretofore Exhibit No. 15 in the proceedings No. 109,993, said document consisting of the judgment role or an action in the Superior Court of the State of California, in and for the County of [64] Yolo, in the matter of the legality of the existence of Reclamation District No. 2035, and the same consisting of the complaint in such proceeding, the affidavit of publication, certain exhibits, the findings of fact, and the judgment therein, and other documents.

The Court: Judgment of what, some court?

Mr. Acet: The Superior Court of Yolo County.

The Court: California?

Mr. Acet: California, and the complaint is entitled, "To Determine the Legality of the Existence of Reclamation District No. 2035."

The Court: All of those papers are contained together, are they?

Mr. Acet: Fastened together. I imagine there are 20 or 30 pages, and the judgment purports to find the proceedings——

The Court: What is the date of the judgment?

Mr. Acet: The judgment is dated June 29, 1920,

the time of the formation, shortly after the formation.

The Court: It will be received in evidence as Petitioner's Exhibit No. 5.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 5.)

Mr. Acret: At this time we offer an instrument proposed to be marked as Petitioner's Exhibit No. 6, the same being [65] and purporting to be a certified copy of the judgment role in an action in the Superior Court of the State of California, in and for the County of Yolo, and entitled, "Reclamation District No. 2035, Plaintiff, versus The Lands of Reclamation District No. 2035 and All Persons Owning the Same or Interested Therein, Defendants," and the judgment therein, purporting to pass upon the legality of the first two million dollar issue of bonds, Nos. 1 to 2,265, and dated, and if your Honor will mark this, from January 1, 1935, when the first group of 227 came due, to January 1, 1944. That is when the last one became due in that first issue.

The Court: That will be admitted as Petitioner's Exhibit No. 6.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 6.)

Mr. Acret: I am emphasizing that because it is somewhat at variance of counsel's understanding of the facts, as indicated by part of the opening state-



ment. The bonds were 20-year bonds, instead of 10-year bonds.

Mr. Crouter: If your Honor please, Respondent's position on that is exactly the same as to Exhibit No. 5.

The Court: Yes, I understand Respondent has an exception.

Mr. Acret: I emphasize that for your Honor's information at this time. That is Exhibit No. 6. [66]

We offer in evidence at this time a certified—and by the way, that last Exhibit was also an Exhibit in the former case.

The Clerk: This is a certified copy?

Mr. Acret: This is a certified copy. We offer in evidence at this time an instrument proposed to be marked as Petitioner's Exhibit No. 7, the same purporting to be a certified copy of the judgment role in an action in the Superior Court of said County and State, in the matter of the legality and validity of refunding bonds of Reclamation District No. 2035, authorized at an election held in said District on December 4, 1934, the complaint entitled, "Action to Establish Validity of Refunding Bonds Aggregating the Principal Sum of Two Thousand Dollars."

The Court: Now, that is admitted—that those bonds are the bonds involved here?

Mr. Crouter: No, that is not admitted.

The Court: I don't know what the number of the district is. Is the number of the district contained in that the same as number of district the Petitioner owns and has?

Mr. Acret: 2035.

Mr. Crouter: The same Reclamation District. There is a question of issuance and reissuance of bonds, if the Court please, and I don't know whether that brings it through the taxable year or not. [67]

Mr. Acret: We will connect it up.

The Court: I wanted to be sure these matters were related to the matters before the Court.

Mr. Crouter: Respondent's position is the same as to Exhibit No. 5. Respondent admits there are some relevant matters shown there, but does not wish to be bound by any of it.

Mr. Acret: I take it, your Honor, it is helpful for me to summarize, by way of information, as we go along, the contents of these, so your Honor will follow the chronological progress. We will connect this up. The complaint alleges——

The Court: You are referring to Exhibit No.——

Mr. Acret: Proposed No. 7. The complaint alleges the issuance of the election for refunding issuance of refunding bonds, the issuance of the outstanding bonds of two million dollars, heretofore referred to in the former Exhibit, and lists them, and that is a copy of the Notice of Election, the certificate of the results of the election, and the listing and issuance of the refunding bonds, coming due, commencing January 1, 1945, and up to January 1, 1948, in the total amount of \$2,000,000.00. It contains the allegations of the various proceedings, and it contains the resolution of the board of trustees, with relation to said former issue and of said new issue, and a complete list of the bonds and a receipt of the county treasurer for such new issue of the bonds, the

same being [68] No. R-1, the "R" I presume standing for refunding; 2-R, two thousand, totaling \$2,000,000.00, and the judgment, the document contains affidavit of publication, an order—

The Court: What is the date of the judgment?

Mr. Acret: —notice of publication, summons, and the date of judgment is—the judgment recites apparently the same as the complaint, findings, the issuance of the bonds, and is dated June 25, 1935.

The Court: That will be received as Petitioner's Exhibit No. 7.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 7.)

Mr. Acret: And I have a copy of bond number 2,000, a photostatic copy. I don't know whether counsel will take my word for this or not. I don't know what has become of the original. It was returned to us marked "Cancelled on exchange for refunding bond No. R-2,000, E. O. R., E. Cole, County Treasurer," and I submit that is a sample of the other bonds. Also, we will connect it up with further testimony.

Mr. Crouter: If your Honor please, I would like to examine this for a moment. It has fine printing, and so forth.

The Court: Have you something else you can offer while counsel is examining that?

Mr. Acret: I wonder if we could take a recess? Does your Honor take a recess at midafternoon?

The Court: I think so. We will take a ten minute recess.

(Short recess taken.)

The Court: When we took a recess, counsel for Petitioner had indicated an introduction of some document that Respondent wanted to examine. Is that ready?

Mr. Crouter: Yes, I have examined that, if the Court please, and I have no objection to the document being received in evidence.

The Court: What is the document?

Mr. Acret: It is a photostatic copy of what purports to be one of the cancelled bonds of the first issue, which is marked "Cancelled" in the purported handwriting of the County Treasurer of Yolo County.

The Court: I understand Petitioner is going to connect that as being a copy of one of series of bonds here involved.

Mr. Acret: Yes, and I propose at this time to put Mr. Landrum on the stand.

The Court: The document just marked will be introduced in evidence at Petitioner's Exhibit No. 8.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 8.)

Mr. Acret: Take the stand, Mr. Landrum, please.

The Court: The witness has already been sworn, as [70] I recall.

Mr. Acret: As I recall it, yes.

Whereupon,

ROBERT R. LANDRUM

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Acret:

Q. You were secretary of the Birch Securities Company in 1944?

A. Birch Securities Company—no, 1934.

Q. I will withdraw the question.

You were secretary of the Birch Ranch & Oil Company, were you, in 1944? A. 1944, yes.

Q. When did you first become secretary of the Birch Ranch & Oil Company?

A. I think it was the latter part of 1937.

Q. Were you such from then on continuously up to and including September 30, 1944? A. Yes.

Q. Were you also an officer of the Birch Securities Company during any part of that time?

A. Yes. [71]

Q. When did you first become an officer of the Birch Securities Company?

A. The latter part of '37.

Q. What was that, secretary?

A. Secretary.

Q. Were you secretary of the Birch Securities Company at the time of the receipt of any of the refunded bonds of Reclamation District 2035?

A. Yes.

Q. About when was that, if you recall?



(Testimony of Robert R. Landrum.)

A. I don't know when they were refunded.

Q. Just approximately. The refunding issue is dated January 1, 1935. Did you receive the bonds——

A. Subsequent to that, shortly afterwards, but I don't know the date.

Q. Is it true that for a period in the 1930's the Birch Securities Company was suspended by the Secretary of the State of California?

A. They were suspended—you say in the 30's; sometime after '37.

Q. And by reason of such suspension, was there delay of the Birch Securities Company turning in its old bonds in exchange for the new bonds?

A. Yes.

Q. And such delay was caused by that suspension; that is, [72] such delay as there was in turning in the bonds?      A. Yes.

Q. Under the Franchise Tax Statute, you understood it was a misdemeanor for a suspended corporation to transact any business?      A. Yes.

Q. And you were advised by your attorney that turning in the bonds would be construed as transacting business?      A. Yes.

Q. Did Birch Securities Company finally get an order through the District Court of the United States from the Secretary of State in enjoining suspension?      A. Yes.

Q. Did you, sometime subsequent to January 1, 1935, then turn in the old bonds that were owned by the Birch Securities Company for the refunded bonds?

(Testimony of Robert R. Landrum.)

Mr. Crouter: If your Honor please, I must object to this question, on the ground it is leading, and apparently purports to cover things of a documentary evidence nature, concerning which I believe there should be written records which would best show exactly what happened.

The Court: Let counsel refrain from leading the witness.

Mr. Acret: I was doing that in the interest of time, and didn't consider counsel would make any point of it. [73]

Q. (By Mr. Acret): I show you Exhibit No. 7, which is the judgment role of the Superior Court, with reference to the refunded bonds, and I will ask you if the Birch Securities Company received from the county treasury any of the bonds that are listed in this judgment role as R-1 to R-2,000?

A. They received them in exchange for the old bonds of a like amount.

Q. And that was subsequent to January 1, 1935?

A. Yes.

Q. Did you have possession of some of the old bonds, as secretary of the Birch Securities Company?

A. We had a few of them.

Q. You are familiar with their form?

A. Yes.

Q. I will show you a photostatic copy of what purports to be one of the old bonds, which is Petitioner's Exhibit 8 herein, and ask you if that is a sample, this one being No. 2,000, if that is a sample

(Testimony of Robert R. Landrum.)

of one of the original bonds of Reclamation District No. 2035? A. I would say that it is.

Q. It is the issue dated January 1, 1925?

A. Yes.

Q. Are you familiar with Mr. Cole's signature?

A. Yes. [74]

Q. The County Treasurer of Yolo County?

A. Yes.

Q. That is his signature?

A. Yes.

Mr. Acret: I conceive that purports to have kept my promise, your Honor, with connecting up that document.

Q. (By Mr. Acret): During the year 1944, did you receive notices of call from the County Treasurer of Yolo County with respect to the assessment, payment of interest on assessment No. 1 of Reclamation District No. 2035?

Mr. Crouter: If your Honor please, the Respondent respectfully objects to the question at this time, on the ground it is leading and calls for a conclusion, and calls for construction of document by the witness.

Mr. Acret: I will withdraw the question.

Mr. Crouter: I told counsel that with respect to the documents clipped together, I have no objection to their going into evidence for what they show.

Mr. Acret: I wanted to identify it, however.

Q. (By Mr. Acret): Did you receive that instrument entitled, "Notice of Call No. 25 of Assess-

(Testimony of Robert R. Landrum.)

ment No. 1," during the year 1935? A. Yes.

Q. Is that a sample of the instrument which you received [75] from time to time from the County Treasurer with reference to assessment calls?

A. Yes.

Q. In response to that assessment, did you send in the money to the County Treasurer, and for that in return receive that receipt from him in the sum of \$60,769.49, dated September 20, 1944?

A. Yes.

Mr. Acret: We offer the same in evidence at this time, three pages as one Exhibit.

Mr. Crouter: No objection.

The Court: Without objection it is admitted as Petitioner's Exhibit No. 9, three papers attached together, the papers just identified by the witness.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 9.)

Mr. Acret: For your Honor's information, there is a certificate attached from the auditor's office, "This is to certify that Birch Ranch & Oil Company has this day paid into the County Treasurer amounts as follows: Payment of call No. 25 of assessment No. 1 of Reclamation District 2035, \$60,769.49, dated September 20, 1944, Fred A. Porter, County Auditor, and Roy E. Cole, County Treasurer."

(Testimony of Robert R. Landrum.)

The Court: You just read from the Exhibit, the last document? [76]

Mr. Acret: Yes, your Honor.

The Court: Exhibit No. 9.

Q. (By Mr. Acret): I call your attention to the fact that Exhibit No. 9 is Check No. 618, and referring to Exhibit No. 1, which is the report of the Internal Revenue Agent in charge, dated January 23, 1947, I call your attention to Item No. 4 under "Amounts Allowed" in this report, consisting of four payments in this year by certified checks as follows: Check No. 618, \$60,769.49—is that the same item? [77] A. Yes.

Mr. Acret: That is the fourth item, your Honor, on this page, in this report.

Q. (By Mr. Acret): I now call your attention to Exhibit No. 1, which is again the first report of the Field Agent in charge, page three thereof. I call your attention to an item, check No. 28,553, dated 12-29-43, in the sum of \$64,422.51 for amounts allowed in this report, under the heading "amounts allowed in this report, consisting of four payments in this year by certified checks as follows." Is that a certified check which you sent to the county treasurer? A. Yes.

Q. In return did you receive the receipt there from the county treasurer? A. Yes.

Mr. Acret: We offer the certified check to be received in evidence, the receipt being in form simi-



(Testimony of Robert R. Landrum.)

lar to the first one, except it says, "Receipt in payment of Call No. 23."

The Court: A separate document you are offering?

Mr. Crouter: I have no objection.

Mr. Acret: I am offering the check and receipt together, as one document.

The Court: Are they attached together?

Mr. Acret: I will ask that they be attached. [78]

The Court: They will be admitted without objection as Petitioner's Exhibit No. 10.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 10.)

Q. (By Mr. Acret): Did you receive the Call No. 23 referred to in that receipt? A. Yes.

Q. And paid the item in response to that call?

A. Yes.

Q. That is, that was paid for and on behalf of Birch Ranch and Oil Company?

A. That is right.

Q. I show you now a certified check number 29537, to Roy E. Cole, treasurer, dated January 23, 1944, in the sum of—dated June 26, 1944, in the sum of \$59,093.59. Is your testimony the same with regard to that? A. Yes.

Q. And you received the receipt back from the county treasurer, along with this check that I am showing you? A. Yes.

(Testimony of Robert R. Landrum.)

Q. And that corresponds to item number 2 that is shown on page 3 of the Internal Revenue Agent's first report? A. That's right.

Q. Exhibit No. 1? [79] A. Yes.

Mr. Acret: I offer this in evidence, your Honor.

The Court: One or two papers?

Mr. Acret: Two papers, check and receipt attached.

Mr. Crouter: No objection.

The Court: They will be attached together and marked Petitioner's Exhibit No. 11.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 11.)

Q. (By Mr. Acret): The next item is 37,000, is it? A. Yes.

Mr. Acret: I will put in a photostat of that, if counsel will consent to it. I have shown the other checks heretofore. It is temporarily misplaced.

Mr. Crouter: I have no objection to this check and the related documents being received.

Q. (By Mr. Acret): I show you a photostat of a certified check dated August 11, 1944, number 3601, in the sum of \$37,325.28, payable to Roy E. Cole, treasurer of Yolo County. Did you pay this, together with auditor's receipt to cover a portion of Call No. 21, dated December 5, 1935, together with penalty thereon of Reclamation District No. 2035, did you send that check to the county treas-

(Testimony of Robert R. Landrum.)

urer in behalf of Birch Ranch & Oil [80] Company?      A. Yes.

Q. To pay the Call referred to in the receipt?

A. Yes, No. 21.

Q. And you suffered a penalty for that payment being late?      A. Yes.

Q. What did the penalty consist of?

A. I think ten per cent of the amount called; I am not sure.

Q. Why did you only pay the portion of it, if you remember?

A. They made a call for a portion of it, so we paid what they called for. We always pay upon the call, whatever the call is.

Mr. Acet: We offer the photostatic copy of the check and photostatic copy of the receipt as one exhibit.

The Court: That is the document just identified by the witness. It will be received in evidence as Petitioner's Exhibit No. 12.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 12.)

Q. (By Mr. Acet): Mr. Landrum, while you were secretary, did you [81] receive a document entitled, "Report," dated March 23, 1947, from the Internal Revenue Department, of which Exhibit No. 1 I show you is a copy?      A. Yes.

Q. In reliance on the statements therein contained, "that the Birch Ranch & Oil Company is

(Testimony of Robert R. Landrum.)

held by Judge Turner's decision to be on a cash basis," and in reliance on the fact that your loss that is shown on your income tax return for 1944 was changed from eighty-four thousand odd to one hundred eighty-six thousand odd, did you consult me with reference to your rights with regard to that loss?

Mr. Crouter: If your Honor please, Respondent respectfully objects to the question, on the ground it is leading and suggestive, and that it calls for a conclusion and construction and so forth by the witness, whether he relied, and so forth. I believe he should testify to the facts.

The Court: The question is leading, and I think we might simplify it to eliminate the objection.

Mr. Acret: The question was with respect to that report, as it said so-and-so; did he consult me?

The Witness: Yes, I did.

Q. (By Mr. Acret): What advice did you receive with respect to that item of \$186,000.00?

Mr. Crouter: Did your Honor rule? [82]

The Court: I permitted him to say he did consult counsel.

Q. (By Mr. Acret): Do you understand the question? What advice did you receive from me with respect to that loss of \$186,000.00?

A. The 1941 return was involved at the same time as the 1942, both of which the agent of the Treasury Department claimed there was a tax due, after he had audited those years, 1941 and 1942, and the question was whether we would pay both

(Testimony of Robert R. Landrum.)

of them or not, and you advised, inasmuch as this audit had been made here, just referred to under date of January 28, 1947, that we were on the cash basis. Therefore, we would have nothing to carry back to 1941 from any subsequent year, and that we should pay the 1941 return, relying upon this audit here to wipe out any tax that may be in 1942.

Q. Did you then pay the 1941, on receipt of that advice?      A. We did.

Q. In reliance, as you have stated?

A. Yes.

Q. And that was the amount in the sum of twelve thousand odd dollars?      A. Yes.

Mr. Acret: Take the witness. [83]

### Cross-Examination

By Mr. Crouter:

Q. Mr. Landrum, were you secretary of Birch Securities continuously down to, what time?

A. Down to date of its dissolution?

Q. What date?

A. Date of dissolution in 1944.

Q. What was the date of dissolution?

Mr. Acret: Just a moment. Unless the date of dissolution is prior to September 30th, it is immaterial here.

The Court: I don't know whether it is prior or subsequent. He asked what was the date of dissolution.

Mr. Acret: If he knows. The certificate would be the best evidence.



(Testimony of Robert R. Landrum.)

The Court: You have reference to the dissolution of what corporation?

Mr. Crouter: Birch Securities Corporation, if he knows.

Mr. Acret: That is objected to as immaterial.

The Court: That is one of the subsidiaries, as I understand it?

Mr. Acret: Well, I don't know as you would call them subsidiary, but it is one of the corporations Mr. Birch controlled.

The Court: I will overrule the objection. I [84] don't know what the purpose of it is.

Mr. Acret: For the sake of brevity, as well as in fairness to us, we are not prepared to meet anything outside of the issues in this case.

The Court: What is the purpose, I will ask Respondent counsel, of this testimony concerning Birch Securities?

Mr. Crouter: Counsel himself brought out that Birch Securities Company was suspended, and I just want to find out how long ago it was suspended, and I believe some of the documents offered by Petitioner with respect to payments, I think that Birch Securities Company is mentioned on some of these, perhaps not, but it seems to me it is material whether there was a corporation operating and doing business during the times these payments are involved.

Mr. Acret: When the Birch Securities Company was liquidated wouldn't have any bearing on any-

(Testimony of Robert R. Landrum.)

thing counsel said, as to when it was suspended. I will stipulate with counsel that the Secretary of State didn't recognize the judgment of the three-judge court, and the Birch Securities Company is still suspended, and we have the matter in the Supreme Court of the United States now. I don't know how far afield we are going to go.

Mr. Crouter: As my recollection serves me, there was definite testimony in here that Birch Securities Company, at the time of turning in certain bonds, did certain things, [85] and this witness did certain things.

The Court: Does Petitioner agree to that statement.

Mr. Acret: That is right, but the question would be to ask him when they turned them in; not when the company was liquidated. That has no bearing on anything that counsel said.

Mr. Crouter: I withdraw the pending question and ask you this,—

Q. (By Mr. Crouter): During the taxable year 1944, who owned the outstanding stock of the Petitioner corporation, Birch Ranch & Oil Company, if you know?      A. The year 1944?

Q. Yes.

Mr. Acret: That is for the fiscal year 1944.

The Witness: Who owned the stock of the Birch Ranch & Oil Company?

Mr. Crouter: That is correct.

The Witness: It depends on what part of the year.

(Testimony of Robert R. Landrum.)

Mr. Acret: The fiscal year.

Q. (By Mr. Crouter): Let's take October 1, 1943. Can you tell the Court at that date who owned all the outstanding stock of the Petitioner corporation?

A. Well, I will have to answer not directly, if I may, [86] because the stock was issued to Mr. and Mrs. Birch and then exchanged for the stock of the Birch Holding Company, was then in the Birch Holding Company.

Q. So that the Birch Holding Company held all of the outstanding stock of Petitioner, is that correct.

A. That is right.

Mr. Acret: Just a moment, if you please.

Well, it covers matters already stipulated to and it is immaterial to any issue in this case. It is our position that if the Birch Ranch & Oil Company owned all the lands and owned all the bonds, it wouldn't make any difference. There is no Higgins-Smith situation here, because under the law of California one person can own both and still avail themselves of the exemption given them by law.

Mr. Crouter: If counsel can show me where the matter is covered by stipulation, I will be glad to reconsider my question, but it is my understanding that the prior findings and the stipulation do not cover the exact situation in 1944.

Mr. Acret: Don't cover the ownership of the three corporations?

Mr. Crouter: Let's check it. It is not my recollection that they do.

(Testimony of Robert R. Landrum.)

Mr. Acret: My understanding was that they did.

The Court: Counsel ought to be able to agree as to [87] what they show.

Mr. Crouter: Let's just check the stipulation. Maybe we can shorten it this way: I will withdraw the pending question. Mr. Acret, do you stipulate here before the Court that during the taxable year 1944, the Petitioner, Birch Ranch & Oil Company, was wholly owned by Mr. A. Otis Birch and his wife, M. Estelle C. Birch, directly, or by them through another corporation?

Mr. Acret: So stipulated, your Honor.

Mr. Crouter: That covers it.

Mr. Acret: Nevertheless, and we will argue it later, that is immaterial. In other words, it is our position that these bonds could be owned by Mr. and Mrs. Birch themselves, and it would make no difference, as they did for 10 years and it made no difference.

The Court: Proceed with the cross-examination. Any other questions of this witness?

Mr. Crouter: Yes, if the Court please.

Q. (By Mr. Crouter): Mr. Landrum, have you brought to Court or could you obtain and show the Court any correspondence between the Petitioner corporation or any of its officers, on the one hand, and Mr. Cole, the Treasurer of Yolo County, on the other hand, with respect to any of these checks which have been received here in evidence and marked Exhibits 9, 10, 11 and 12? [88]

Mr. Acret: I will state to counsel that I have



(Testimony of Robert R. Landrum.)

the correspondence here and will turn it over to him here in open court for his examination.

Q. (By Mr. Crouter): Mr. Landrum, you have handed to me such correspondence as you could find that relates to each one of these four payments concerning which you heretofore testified?

A. Yes.

Mr. Acret: I will turn over three groups. I don't know whether that covers all of them or not.

Q. (By Mr. Crouter): Please examine the various papers your counsel has handed up, and in order to keep the record as orderly as possible, let's take the earliest check in point of time if we can find it here.

Mr. Acret: Could I interrupt a moment? I know that covers it all, because the first one put in had no correspondence in connection with it, and I have given you three groups, and that is all Mr. Landrum has given me.

Mr. Crouter: Very well.

Q. (By Mr. Crouter): Now, Exhibit No. 10 in the case refers to a certain check dated about December 29, 1943. Do you have or can you find any correspondence on or about that date relating to any so-called call or check; if so, just show me the correspondence. [89]

A. What was the amount?

Q. The amount here is \$58,565.92

A. Yes, I have a letter.

Mr. Acret: I am giving this to counsel, your Honor, so there won't be any question of our good



(Testimony of Robert R. Landrum.)

faith. Nevertheless, when he produces the correspondence, I will object to it as immaterial. He can see all the correspondence he wants to, but it doesn't make any difference what it is, the Treasurer sends his call in compliance with the law.

Q. (By Mr. Crouter): You have shown me a letter dated December 18, 1943,—

The Court: From whom to whom?

Mr. Crouter: This is to the Birch Ranch & Oil Company from Roy E. Cole, Treasurer of Yolo County.

Q. (By Mr. Crouter): Is this the only communication you can find on or about that date, or the only one you have found?

A. I don't seem to have any that pertains to that, other than that letter.

Q. Did you find any copy of a letter, any letter, from the Birch Ranch & Oil Company or any officer of that company to the Treasurer of Yolo County, on or about that date or just before that date?

A. I have a letter here dated December 28, 1943, to [90] Roy E. Cole from Birch Securities Company.

Q. May I see that?

A. I don't think it refers to that particular item.

Q. It does not refer to any of that same matter. Very well, I just wanted to be certain we have all the correspondence.

A. No, that doesn't have any reference to that.

(Testimony of Robert R. Landrum.)

Mr. Crouter: If your Honor please, Respondent at this time offers in evidence the letter identified by the witness dated December 18, 1943.

The Court: Any objection?

Mr. Acret: No objection.

The Court: It will be admitted as Respondent's Exhibit No. B.

(The document above referred to was received in evidence and marked Respondent's Exhibit B.)

Q. (By Mr. Crouter): Now, Mr. Landrum, Exhibit No. 11 in the case refers to a check dated June 26, 1944. Please examine your papers and see whether you have any correspondence at all relating to any check for about \$53,721.65.

Mr. Acret: May it be understood, counsel, you are asking the witness to refer to papers which we have produced here ourselves?

Mr. Crouter: Pursuant to my request.

Mr. Acret: Pursuant to your request just made here [91] in court.

Mr. Crouter: And previously, also.

Mr. Acret: Made to me orally; that is correct.

Mr. Crouter: Yes.

Mr. Acret: In other words, I told you I would do so, produce what correspondence we had, and so far as I know, we have done it.

The Witness: I have some correspondence here relating to that payment.

Q. (By Mr. Crouter): You are showing me

(Testimony of Robert R. Landrum.)

certain letters, originals, and one copy, five documents, all clipped together, and these apparently start about April 10. In fact, the first one is dated April 10, 1944, and the last one is dated June 13, 1944. I offer these, if the Court please.

Mr. Acret: Will you show them to me, first

Mr. Crouter: In the meantime, please look at the other two exhibits and see if there is any correspondence relating to Exhibit No. 9 and Exhibit No. 12.

Mr. Acret: No objection to this offer, your Honor.

The Court: Let the document be formally presented for admission, and also tell what it is, so it can be designated properly.

Mr. Crouter: For the record, if the Court please, this is a group of five original letters, a copy of a statement, and an original of a document from the—well, it is labeled “Woodland Democrats, Ed E. Leak Publishing Company, Woodland, California.” It appears to be a statement of some [93] kind.

This is an original dated April 10, 1944, a copy of a letter from Petitioner——

The Court: Are you offering these all as one exhibit?

Mr. Crouter: Yes, I am.

—— a copy of a letter dated April 14, 1944, original of a letter from Mr. Cole to the Petitioner, dated April 19, 1944; an original of a letter from Mr. Cole to the Petitioner dated April 12, 1944, and

(Testimony of Robert R. Landrum.)

an original letter from Mr. Cole to the Petitioner dated June 13, 1944.

The Court: How many sheets of paper are contained?

Mr. Crouter: Five, altogether.

The Court: The five sheets just enumerated by Respondent's counsel will be admitted in evidence as Respondent's Exhibit No. C.

(The documents above referred to were received in evidence and marked Respondent's Exhibit No. C.)

Mr. Acret: Counsel, could I interrupt you a minute. During the recess, you submitted to me about putting in the tax return for 1942. I suggest we do that at this time, before the close of the day, so we won't forget it.

Mr. Crouter: I have it on my table. I will be glad to. [94]

Mr. Acret: Will you remember it?

Mr. Crouter: You see that I don't overlook it?

Mr. Acret: I suggest we offer it, put it in right now, while we think of it.

Mr. Crouter: If that is agreeable to the Court.

The Court: It will be admitted as Joint Exhibit—

Mr. Crouter: If your Honor please, that does break up our sequence relating to the other matters.

The Court: All right. Proceed with the examination of the witness.

Q. (By Mr. Crouter): Mr. Landrum, the next

(Testimony of Robert R. Landrum.)

group of letters relating to the next check, please.

A. A package of letters, various of them, starting with——

Q. Can you tell me how many originals or copies and how many letters are all clipped together?

A. Three original letters, that is, three original letters from R. E. Cole, Treasurer of Yolo County.

Q. And two retained copies?

A. And three copies of letters written to Roy E. Cole, County Treasurer, by Birch Ranch & Oil Company, and attached to it——

Mr. Acet: That has been put in, the photostat was put in.

The Witness: There is a receipt from the [95] County Auditor, in the amount of \$37,225.28.

Q. Just to make it short, the first two pages are the originals of Exhibit No. 12 in evidence, are they not?

A. That is right.

Mr. Acet: They should be taken off then, so there is no duplication.

Mr. Crouter: At this time the Respondent offers the six letters identified by the witness, and I agree the originals of the others may be removed by counsel, since the photostats are already in evidence.

Mr. Acet: It would be to the Petitioner's advantage if your Honor were reading these and getting the impression of these, the effect of these, as they go in evidence. I know it will be the same in the end. These are quite interesting.

The Court: I would rather read them all at once. They will be admitted. How many sheets are there?



(Testimony of Robert R. Landrum.)

Mr. Crouter: Six different pages.

The Court: All attached together?

Mr. Crouter: That is correct.

The Court: They have just been enumerated by Respondent's counsel, and will be admitted as Respondent's Exhibit No. D.

(The documents above referred to were received in evidence and marked Respondent's Exhibit No. D.) [96]

Q. (By Mr. Crouter): Now, Mr. Landrum, referring to our next check here as shown by Exhibit 9 in evidence, and the date on or about September 20, 1944, do you have any correspondence relating to that matter? A. I do not.

Q. None whatever?

A. None for that, but I have some correspondence here relating to Call No. 23, if you can locate that Call No., as shown on the receipts.

Q. What is the date of the letter that refers to such call? Let's see if it is within our taxable period, what is the date?

A. November '43, December '43; November and December.

Mr. Acet: That relates to other matters.

The Witness: I don't think you have Call No. 23 among those. I am not sure.

Q. (By Mr. Crouter): Does this group of letters, all clipped together, relate to the same subject matter?

(Testimony of Robert R. Landrum.)

A. Apparently so.

The Court: What subject matter does it relate to, anything that has been introduced?

Mr. Acret: I am going to object to it as immaterial and not related to any matters he elicited from the witness, [97] and the examination in chief, and has nothing to do with any issues. It is just cluttering up the record.

Mr. Crouter: If your Honor please, the first letter is an original from the Treasurer to the Petitioner, relating to Call No. 23, dated October 18, 1943; the last copy of a letter from the Birch Securities Company to Mr. Cole, dated December 28, 1943, and they purport to relate to certain calls and payments with respect to reclamation bonds.

The Court: All relating to Call 23 or other calls?

Mr. Crouter: They are not all identified, if your Honor please, but by amounts and figures, they might trace through.

The Court: Is Call No. 23 identified by any check that has been offered here? Is that another call?

Mr. Acret: Your Honor, I am going to withdraw my objection, for the reason that this is illustrative of the general process which is followed, and it will be helpful to the Court.

Mr. Crouter: Thank you.

The Court: It may be introduced as Respondent's Exhibit No. E. How many pages are there, so we can know what it is.

Mr. Crouter: This consists of three original let-

(Testimony of Robert R. Landrum.)

ters from Mr. Cole to the Petitioner, and four copies of letters, three of which are from the Petitioner to Mr. Cole, and the [98] last one, December 28, 1943, is from Birch Securities Company to Mr. Cole.

The Court: They will all be admitted as one exhibit, Exhibit E.

(The documents above referred to were received in evidence and marked Respondent's Exhibit No. E.)

Mr. Acret: If I may be permitted to state, this will be helpful to your Honor, in that the first page illustrates the matter that I said we would show in my opening statement, and in that I called your Honor's attention to the fact that the Reclamation Act provides for the buying of interest coupons and turning the coupons in as payment, in exchange for the county treasurer paying for them. It just illustrates the process, as I stated it would, in my opening statement. That may be helpful two months from now when you read the transcript.

Q. (By Mr. Crouter): Mr. Landrum, please tell the Court what usually determined the date that Mr. Cole, the county treasurer, would make a demand of the Petitioner for any payment of money, and—I will stop right there. What usually determined that?

Mr. Acret: Just a moment, please. That is objected to as calling for something he can't tell, what determined [99] a third party to do something, and

(Testimony of Robert R. Landrum.)

further than that, it is obvious what determines it. It is what the law of California is.

The Court: If the witness knows, he can say.

The Witness: I do not know.

Q. (By Mr. Crouter): Referring to Exhibit B, this being a letter from Mr. Cole to Birch Ranch and Oil, dated December 18, 1943, and the last paragraph reading as follows: "I will appreciate a letter from you, so that I may know what to expect in the matter of business connected with District No. 2035."

I will ask you first, did you usually receive communications from Mr. Cole and act for the company?

A. No, sir, I never did. I didn't even answer that, that I know of. I couldn't.

Q. Then you had nothing whatever to do with the question of issuance of any checks to the County Treasurer. Is that your testimony?

A. That is my testimony. I couldn't tell him what to do.

Mr. Acret: Excuse me. I think the witness misunderstood the question.

Mr. Crouter: I thought he answered it.

The Witness: I said I couldn't tell the county treasurer what to do, even though he would ask me. I could suggest something, but I certainly couldn't order him. [100]

Q. (By Mr. Crouter): During 1943 and 1944, did you work for the Birch Ranch and Oil Company? A. Yes.

(Testimony of Robert R. Landrum.)

Q. What was your position?

A. Secretary.

Q. Did you handle any correspondence at all for and on behalf of the corporation? A. Yes.

Q. Did you handle any correspondence with Mr. Cole, the treasurer of Yolo county?

A. Yes, I did.

Mr. Acret: Just a moment. This is objected to as argumentative. The witness has just identified all the correspondence and now counsel is asking him if he handled that.

The Court: I assume it is introductory to some other question.

Q. (By Mr. Crouter): Did you receive any of these letters which we have identified here from Mr. Cole, on behalf of the corporation? Did you receive them and do anything with them?

A. I suppose we did. You have got them there before you.

Q. I mean, did you act for the corporation, or did some one else handle all this? [101]

A. If I had any letters there, I handled them. How are the letters signed, secretary?

Q. Well, this one, Exhibit C, has no initials, but I am referring to the letter of April 14, 1944, and it is signed "Birch Ranch and Oil Company, by . . . . . " and "Secretary" below.

A. I must have signed it.

Q. Were you the only secretary at the time?

A. I don't know just what you mean. There is only one secretary of a corporation.



(Testimony of Robert R. Landrum.)

Q. And you usually signed mail for the corporation, when the secretary signed them?

A. Yes.

Q. Now, this letter I referred to of April 14, refers to reconciling certain figures. Does that just refer to totals of payment to the county, or does that refer to payments from the county also?

A. From the county—I don't know what you mean.

Q. I believe you stated you don't know.

A. I don't know what you mean.

Q. Referring to the second inset paragraph where it states, "To cover interest coupons submitted for payment, \$120,000.00." I will ask you this: Please tell the Court whether it was the practice to make a payment to the treasurer from the corporation or on behalf of the corporation, and about the same time interest coupons would be clipped from bonds and presented to the county treasurer, and the treasurer would also make a payment to the Birch Ranch and Oil Company, or to Mr. Birch, individually?

Mr. Acret: Just a moment. That is objected to as multiple, and I don't think the treasurer would make a payment to the Birch Ranch and Oil Company.

Mr. Crouter: I said, "or Mr. Birch, individually."

Mr. Acret: You don't mean to Birch Ranch and Oil Company. Objection; question multiple.

Q. (By Mr. Crouter): And make a payment to Mr. Birch individually?

(Testimony of Robert R. Landrum.)

Mr. Acret: Objection now. The question is understandable.

The Court: If the witness understands, answer the question.

The Witness: No, sir, I do not understand the question.

The Court: Will counsel kindly restate it.

Mr. Crouter: I withdraw the pending question.

Q. (By Mr. Crouter): Please tell the Court whether on any occasion, during the fiscal year 1944, there was a payment made to the county treasurer by and on behalf of the Petitioner corporation, and about the same time, we will say, within a few days, at least, [103] there would be a payment of approximately the same amount from the county treasurer to Mr. Birch or to someone on his behalf?

Mr. Acret: Just a moment. That is objected to as immaterial and multiple.

The Court: I will overrule the objection. Will the witness answer the question, if he knows.

The Witness: I don't know all the ramifications of the county treasurer's office, or how he does things, or how Mr. Birch handles his matters. Those coupons are out of my jurisdiction entirely. I am merely referring in this letter here to the calculations, how he arrived at certain figures, but I don't have anything to do with the coupons.

Q. (By Mr. Crouter): Do you know whether any coupons were presented to the county treasurer at any time for payment of any interest on those coupons and redeeming the coupons, turning them

(Testimony of Robert R. Landrum.)

back to the treasurer, during the fiscal year 1944?

A. Yes. First, let me say that all of these bonds that were owned by the Birch Securities Company were in a trust at the Citizens National Trust and Savings Bank, as security, under an agreement that Mr. Birch had with the Hopkins sisters, so-called, so at any time there was a call being made by Mr. Cole, when the call was made, I will say, those coupons had to be clipped from those bonds by the trustees of that trust. Mr. Frank B. Olds was one of the trustees, and C. Harold Hopkins [104] was the other trustee. They would go down to the bank, clip the coupons, and send them up to Mr. Cole. Sometimes they would remain there until he made a call, so they would be on hand. Mr. Hopkins wasn't always available. He traveled around. So about the time an interest was due, a payment for interest, he would clip these coupons off and send them up there, and Mr. Cole would keep them in a safe securely there.

Th Court: Who would clip them off?

The Witness: The trustees of this trust.

The Court: That is at the bank?

The Witness: Yes, sir. That is about all I can explain about that.

Q. (By Mr. Crouter): Was it the usual practice that about the time of a payment from the Petitioner corporation to the treasurer, there would be a similar payment from the county treasurer to anyone who presented the bond coupons?

Mr. Acret: Just a moment. That is objected

(Testimony of Robert R. Landrum.)

to as immaterial, calls for a conclusion, and not the best evidence.

Mr. Crouter: I am just asking insofar as he knows.

Mr. Acret: I think he already said he didn't know.

The Witness: So far as the county treasurer is concerned, he wouldn't hold the money any longer than he had to. If he had the money, he would pay it upon the presentation of the coupons, no matter who presented them. [105]

Q. (By Mr. Crouter): Please tell the Court whether it was the practice, during the fiscal year 1944, and it did happen there with four payments from the county treasurer, on the bond coupons, in almost the same amount that was paid to the treasurer. In other words, the record here indicates that the four checks in evidence seem to total \$221,-610.87. Please tell the Court, if you know, whether approximately the same amount was paid out on bond coupons during that fiscal year and at about the same time of the payments that were made to the treasurer.

Mr. Acret: Your Honor, that is calling for a witness' guess. How could a man other than guess?

The Court: He either knows or he doesn't know. If he knows, he can say so; if he doesn't know, he can say so.

The Witness: I would have to verify those figures. I couldn't answer right off.



(Testimony of Robert R. Landrum.)

The Court: You would have to verify them, you say?

The Witness: Yes.

The Court: How long would it take?

The Witness: He has all my correspondence there, for one thing.

The Court: The witness says he can't do it without verification. [106]

Q. (By Mr. Crouter): Are there any books or records available in court that you could consult and answer the question?

A. As I said before, I have nothing to do with the coupons. I can show you how much was paid.

Q. Did you keep any records at all with respect to amounts paid on bond coupons?

A. I surely do.

Q. Do you have any such records available in Court? A. Yes.

Q. Will you please consult such records, so we can examine and see what was done?

The Court: We will take a five-minute recess while the witness is making an examination.

(Short recess taken.)

The Court: Mr. Landrum, resume the stand, please.

Q. (By Mr. Crouter): Did you find any record with respect to amounts of interest received from the county?

A. No, sir. I misunderstood the question before. I remember some, however.

Q. Please tell the Court what you remember, if



(Testimony of Robert R. Landrum.)

anything, that transpired with respect to that matter during the fiscal year 1944, and if you care to refer to——

A. The Birch Ranch and Oil Company bought 86 of those bonds from the Great Republic Life Insurance Company, who [107] owned them at that time. The Birch Ranch and Oil Company purchased them in 1940. Those bonds had some back interest on them, and we acquired that back interest, and subsequent to buying them, and at the time, or soon after, let's see—1943, we started paying taxes to the county treasurer, upon his calls. The Birch Ranch and Oil Company, owning the 86 bonds, they would present those coupons for payment. Now, that interest is on the books, but I don't have it with me here.

Q. Mr. Landrum, is there any complete list or is there any definite written evidence that you could refer to here, so that you could tell the Court the exact situation as to what, if any, bonds were outstanding, that is, bonds in the reclamation district, during the fiscal year 1944, and who held those bonds?

A. I don't believe I can do that, even if the papers were presented to me. It is a very complicated matter.

Mr. Acret: I would like to state to counsel and your Honor that Mr. Birch is going to take the stand, and he is familiar with that situation.

Mr. Crouter: It will be shown by him?

(Testimony of Robert R. Landrum.)

Mr. Acret: He will be able to so testify, I believe.

Q. (By Mr. Crouter): Now, Mr. Landrum, referring back again to Exhibit C in evidence, I call your attention to the third paragraph of [108] this letter from Mr. Cole, which is addressed to Birch Ranch and Oil Company, June 13, 1944, and I read as follows: "If this call remains unpaid, we will be unable to pay interest coupons due July 1st."

Now, does that refresh your recollection at all as to how those matters were usually handled, so you can tell the Court any more about it?

Mr. Acret: I think the letter speaks for itself.

The Court: Well, counsel is asking him if he can refresh his recollection on some previous question. I will overrule the objection.

The Witness: I don't know what he has reference to, other than what he says. He says it can't be paid. If you don't pay the assessment—he couldn't pay the coupon unless we paid our assessment.

Q. Is that what a coupon payment by the county treasurer usually depends upon?

A. It depended on the interest on the call to pay.

Q. If he did not have money on hand, that had been received from these calls, he would not have money to pay the interest. Is that the way it works?

A. Yes, sir.

Q. And sometimes would there be amounts, I mean, coupons, which could have been presented

(Testimony of Robert R. Landrum.)

but they were not presented or paid, because the county treasurer had no money from these calls?

A. If they presented it and he had no money, he couldn't pay them.

Q. Did that ever happen, that you know of?

A. Not to my particular knowledge right at the moment. I don't know of any case.

Q. Now, referring to the second letter in Exhibit C, reading as follows—this is a letter, if the Court please, from Mr. Cole to the Petitioner, dated April 12, 1944, and reads: "This call is for \$53,721.65, which sum, together with the balance on hand, will be sufficient for the payment of sixty thousand dollars coupons due July 1st. As a matter of fact, there will be a remainder over after payment of the sixty thousand dollars."

Now, after seeing that, please tell the Court whether it is correct that it was the usual practice to collect a certain amount from the Birch Ranch and Oil Company, and then pay out either the identical amount or substantially the same amount on bond coupons?

Mr. Acret: I object to this witness testifying what is the usual practice of the county treasurer.

The Court: I will overrule the objection. If the witness knows, he ought to tell.

The Witness: I will answer that by saying that the county treasurer is guided by certain rules in calculating the amount of calls that he is to make. It is never for the same [110] amount as the interest. It is a very complicated system, and in one

(Testimony of Robert R. Landrum.)

of the exhibits you now have, he explains just how that call is made and how it is calculated. That is the thing I was trying to find out about in some of the correspondence I had with him. That is what he has reference to in this paragraph you just read. He always has a certain amount left over to carry on to the next call. It is always a few thousand dollars, but that is the way the law requires him to calculate these calls. He can't deviate from that.

Q. (By Mr. Crouter): Please tell the Court whether it is true that no amounts would be paid on interest unless they had been previously collected on these calls. A. That is correct.

Mr. Acet: I object. Already asked and answered.

The Court: He has answered that. For the second time, he has answered that.

Q. (By Mr. Crouter): And that same thing is shown—first, I will ask you, did you dictate and send the first letter here of December 28, 1943, in Exhibit E? A. Yes.

Q. And that is the same matter you referred to when, in the last paragraph, where you state: "Where funds are available, will you please redeem the above numbered coupons, together [111] with the twelve seventy-eight to be delivered to you by Mr. Hopkins," and so forth?

A. That is right.

Q. As a matter of fact, sometimes the payment of any money to the county treasurer by the Peti-



(Testimony of Robert R. Landrum.)

tioner was conditioned upon the payment of interest on coupons at or about the same time, isn't that a fact, as shown by paragraph two of your letter of August 3, 1944, which is Exhibit D?

Mr. Acret: That is objected to as calling for a conclusion of the witness; argumentative.

The Court: Objection sustained. That is just a repetition of what has already been said. If it is not in evidence, I will admit it, but the Court understood that he had answered.

Q. (By Mr. Crouter): Referring to your testimony that the Birch Securities Company was suspended at the time of certain refunding of bonds, what time did you refer to, 1935?

A. I wasn't here in 1935. I don't know—

Q. As I recall, you were asked whether the Birch Securities Company, at the time of the turning in and receipt of any refunding bonds, was suspended. Didn't you answer yes?

Mr. Acret: I don't think that is the question.

The Witness: Yes, but the suspension took place after 1935. [112]

Q. (By Mr. Crouter): How long was it suspended?

A. Sometime after '37. It was suspended after '37, I believe.

Q. How long did it remain suspended?

A. Still is, so far as I know.

Q. Then, the Birch Securities Company was suspended from operations during all of the taxable year 1944?

A. It was dissolved in 1944.



(Testimony of Robert R. Landrum.)

Mr. Acret: I object to the witness volunteering. The dissolution has nothing to do with it, and is outside the fiscal year of 1944.

The Court: I will overrule the objection. If he knows when it was suspended, he can say.

The Witness: I don't know exactly when it was suspended.

Q. (By Mr. Crouter): Do you know whether Birch Securities Company was in existence at all during the tax year 1944, as an active corporation, licensed to do business?

Mr. Acret: Could I hear the question?

(The question was read.)

Mr. Acret: That is objected to as calling for a conclusion; immaterial.

The Court: Do you know whether that is true or not? [113]

The Witness: That is a legal question. I would rather not answer it.

The Court: You don't know what steps had been taken toward its dissolution at that time, then?

The Witness: I know that we went through the process of dissolving it. As to the legality of it, that is not for me to answer.

The Court: The witness can't answer that.

Q. (By Mr. Crouter): Did the question of suspension of that corporation have anything to do with the refunding of any bonds of the Reclamation District or the holding up of any refunding of any such bonds?

(Testimony of Robert R. Landrum.)

A. Not to my knowledge.

Mr. Acret: I may have mislead counsel on that. I was mistaken. I thought at the time when I asked the question I did that was the case, but I recall now that the auditors held it up. I will ask the witness on redirect examination some further questions on that subject.

Q. (By Mr. Crouter): The cause of suspension was on account of certain tax claims made by the State of California, isn't that right? The company refused to pay them?

A. You mean, the suspension was?

Q. Yes. [114]

Mr. Acret: Do you want a stipulation on that? I will make an offer. I offer to stipulate that the Birch Securities Company was suspended sometime, I think, commencing as late as 1939, probably, on the ground of nonpayment of a deficiency assessment, and took the position, and has ever since taken the position, it wasn't subject to the jurisdiction of the State Franchise Tax Commissioner, because it isn't doing business in California. That was being litigated before the Supreme Court.

Mr. Crouter: I appreciate counsel's stipulation, but I know nothing about it, so I can't stipulate. Thank you very much.

Q. (By Mr. Crouter): Referring to Exhibit 4 in evidence, this being the collector's receipt for a payment of \$12,398.85. You do not know of any assessment of that tax against the corporation for

(Testimony of Robert R. Landrum.)

that year, do you? Has there been any assessment you know of?

Mr. Acret: That is objected to as immaterial, argumentative and understandable. What would an assessment against the corporation have to do with this witness paying a deficiency assessment made by the Collector of Internal Revenue in order to conform with his report?

The Court: If the witness knows, he can say so. If he doesn't know, he can say so. [115]

The Witness: The receipt calls for taxes for the fiscal year September 30, 1941. I went up and paid it myself.

Q. (By Mr. Crouter): Did you ever receive a notice and demand from the collector for that year, and with respect to that identical amount?

A. I paid what they asked for, your Treasury Department, and it was for the year 1941. It was right after leaving this court room.

Q. Was there any conversation about that amount being held in a suspense account by the collector; I will say a suspense account, pending the outcome of this case?

A. That is something I can't answer.

Q. I am asking you, was there conversation?

A. I don't know.

Q. Did you, yourself, handle it or turn it in?

A. I was told by our attorney to go up and pay the 1941 taxes, and I did.

Q. Did you come in personally?

(Testimony of Robert R. Landrum.)

A. I went right down there and paid it and got the receipt.

Q. To the collector's office?

A. In this building somewhere.

Mr. Crouter: My only point on that, if the Court please, this relates to the estoppel question, and will take [116] notice of the fact that no decision has been entered and the law will prohibit assessment. I merely wanted to show the status of the twelve thousand dollars at this time. I offer a certificate for the collector of this district, referring to the status of all assessments and collections of the Birch Ranch and Oil Company for all years, 1934 through 1947.

Mr. Acret: Your Honor, with respect to paying this assessment, deficiency assessment is set up as an Exhibit A to the Petitioner herein, and certainly can't have any bearing on the question of estoppel, when we find out, after we file the petition, that Judge Turner's decision, and that the commissioner takes the position we are on a cash basis, and then if we are generous enough to say we have no opposition and this petition isn't taken properly then, if they are on a cash basis, we didn't pay it and we will go pay it now. The question of the estoppel still comes in. We paid it in reliance on this position taken in the first report.

Mr. Crouter: If your Honor please, I would merely like to say—I am not trying to foreclose Petitioner in any respect on the question of estoppel, but I am trying to furnish the Court and have



(Testimony of Robert R. Landrum.)

in the record the exact status of the collector's account with respect to that matter, so it will be fully and clearly evident.

The Court: Whatever the witness knows about, he can tell. [117]

Mr. Crouter: Well, the document offered is a certificate signed by the collector, original certificate, usual certificate of assessments and collections, and the Court can see what is shown here.

The Court: Has that been offered?

Mr. Crouter: That is pending offer now.

The Court: If the witness knows anything about it, he can testify about it, identify it. It seems to be a statement from the Collector of Internal Revenue. Let counsel look at it.

Mr. Acret: It is objected to as immaterial and hearsay and irrelevant.

The Court: Does the witness know anything about this document? That is what the Court wants to know.

The Witness: I have never seen that document.

The Court: Let the witness see what we are talking about.

Q. (By Mr. Crouter): I show you what purports to be an original certificate of the Collector of Internal Revenue for the Sixth District of California, Form Eight Ninety-nine, and I call your attention to the year, fiscal year 1941, as shown on this certificate, together with certain things as to other years, and ask you whether this refreshes your recollection at all as to whether there has been



(Testimony of Robert R. Landrum.)

any actual assessment of the twelve thousand odd taxes for the year 1941?

Mr. Acret: That is objected to as argumentative, your Honor. This proceeding is in response to the assessment for the year 1941, and it is set up as Exhibit A——

The Court: I don't know what the witness knows about it. He has been asked whether he knows about it. If you do, say so.

The Witness: I have never seen this before, and still don't know what it is.

Mr. Crouter: I offer it as an original. Will the Court take judicial notice of the fact that Harry C. Westover is the duly constituted collector of this district, and this is an original certificate over his written signature, with respect to the status of Petitioner's account. I offer this for 1941, to show that exact matter, and offer it also as to all years, in support of the Respondent's position.

The Court: What is the date of this payment made, shown in Exhibit 4?

The Witness: July 7, 1947.

Mr. Acret: In the Commissioner's report, your Honor, showing the loss, was January, 1947, and this assessment that we paid was made under a letter of April 30, 1945.

The Court: This document now before us, dated October 15, 1948, I think counsel had better wait until his testimony to offer this. The witness knows nothing about it. [119]

(Testimony of Robert R. Landrum.)

Mr. Crouter: Very Well.

Q. (By Mr. Crouter): Mr. Landrum, in accordance with your discussion with Mr. Acret and at about the time the amount of the 1941 tax was paid, what, if any, reason was there for not paying the 1942 taxes at the same time?

A. Based upon the audit of the field agent of the Treasury Department, saying we were on a cash basis, and he having found our deductions to be what we had already placed there, and added more to it, so, assuming that we had \$186,000.00 loss, we presumed we could carry that back and wipe out the 1942.

Q. Was there any discussion with Mr. Acret as to the year 1941 still being in the pending docket number, so that any rights of the Petitioner could be investigated before the Tax Court, regardless of the question, whether it was paid or not?

A. No, we knew we had to pay that and wanted to pay the interest on it.

Mr. Acret: Your Honor, I am astonished and surprised that when counsel here corroborates with my opponent to the extent—the minute I find out we don't have a case in any respect, I advise my client to pay the bill, and then have the government complain of it. I do that because I feel it is my duty as a lawyer to no longer make any contentions I don't think I can sustain. We do that and pay that and now [120] counsel wants to take the position as though we had done something wrong. As an honorable gentleman, I say, as to

(Testimony of Robert R. Landrum.)

1941, if we are on a cash basis, our position isn't sustainable, and we give up, so there will be no mistake about it. That is what we did, and paid the bill, and if it is ever found we owe it, we will pay it promptly, and we are well able to, but we don't think, under the law, we are required.

Q. (By Mr. Crouter): Mr. Landrum, from what source and what is the earliest date you knew anything about who the bondholders were of Reclamation District 2035. I refer to these documents you have identified in part, Exhibit No. 5 and Exhibit 6 and Exhibit 7, which seem to relate to certain court proceedings in Yolo County, California?

Mr. Acret: I didn't put Mr. Landrum on with regard to that or ask him anything with regard to it, and counsel is losing time.

The Court: I believe counsel for Petitioner stated that Mr. Birch will cover that?

Mr. Acret: That is right.

The Court: So, counsel, I think you might reserve that examination for him. He can give it more definitely, as I understand it.

Mr. Crouter: If your Honor please, I want to stay within the Court's ruling here, but according to my notes, [121] Exhibit No. 7 was shown to this witness, and there was certain testimony about it. Exhibit 7 relates to certain alleged refunding of bonds, and so forth, and there was testimony about it, and I would like to interrogate on cross-examination about it.

The Court: Anything that pertains to that, the

(Testimony of Robert R. Landrum.)

witness was asked about, but going into the question of ownership of bonds was a matter this witness could give you more accurate information concerning.

Q. (By Mr. Crouter): Referring to Exhibit No. 7, Mr. Landrum, this is the same document which, according to my notes and recollection, you examined when Mr. Acret was asking you questions, and referring to certain alleged refunding of bonds, please tell the Court, in the first place, who handled the originals of records of the reclamation district, and with respect to refunding of bonds, if you know.

A. Our attorneys at that time were Armfield and Eddy, in Woodland, California. He handled all those matters, and I recognize this document here as being connected with that transaction. That is about as far as I can testify to it.

Q. Exhibit 7 has, on the first page, what apparently is the last entry in the proceeding, the very next page showing that the complaint was filed, and filed April 26, 1935. Then, on April—no, on June 25, 1935, there was an order apparently [122] entered by Mr. Harry R. Saunders, clerk of the Superior Court of Yolo County. Now, that date, June 25, 1935, was before you had any connection with any of the Birch corporations, wasn't it?

A. Yes, sir.

Q. Then, please tell the Court whether it is a fact that you, yourself, do not know anything about



(Testimony of Robert R. Landrum.)

there having been any reissuance of bonds of Reclamation District No. 2035 sometime in 1935?

A. I know there was, and this is a certified copy of the document, which was asked for in a previous case.

Q. You just know what is shown by that document?

A. No, I know the bonds were refunded in a subsequent year to '35.

This is a refund—this is a refunding issue, isn't it?

Q. The matter in there refers to refunding of bonds.

A. Well, we had to have this in another case in this court here.

Q. Were you an officer at any time of Reclamation District 2035?      A. Yes.

Q. What was your position with respect to that district?

A. One of the trustees in the latter years.

Q. During what years? [123]

A. I don't remember off hand. I think it was subsequent to 1937 or 1938.

Q. Do you remember whether you were an officer of the reclamation district at any time during the tax year 1944?

A. I think I was. I am not sure. All those matters were handled by our attorneys up there in Woodland, but I think I was.

Q. Armfield and Eddy or Eddy and Armfield?

A. Armfield and Eddy, they called it.



(Testimony of Robert R. Landrum.)

Q. Have you, as an officer of the reclamation district, brought any records of the reclamation district to this court?           A. No.

Mr. Acret: I will object to that question, and I would like to ask a question on voir dire, if that can be asked; I don't know, because I forget, with reference to one's own witness. It is not shown that this witness is an officer of the reclamation district now, and he wouldn't have any authority to bring any records here, and it is not known he is subpoenaed to bring any here or that he has any in his possession.

Mr. Crouter: Well, the question has been asked and answered. I have nothing further.

Mr. Acret: He said he doesn't know; he might have been in 1944. I was trying to get my objection in before the witness answered. I don't want him placed in the position as [124] though he had to bring records here that were not subpoenaed.

Q. (By Mr. Crouter): Can you tell the Court, from your own knowledge, Mr. Landrum, who, if any, were the other trustees of the reclamation district during the tax year 1944?

A. I don't know until I refer to the records. There was very little transactions made in the district at that time, so I don't know.

Mr. Crouter: No further questions. Thank you.

The Court: Any further questions by Petitioner of this witness?

Mr. Acret: I have one or two on redirect.

(Testimony of Robert R. Landrum.)

Redirect Examination

By Mr. Acret:

Q. Counsel asked you if it ever happened that coupons were presented and not paid, and you stated you didn't recall. I want to ask you now if this will recall anything to your recollection: Do you know why the Birch Ranch and Oil Company bought the Great Republic Life Insurance bonds?

A. Yes, I know why.

Q. What was the reason?

A. Because we were sued by the Great Republic Life for payment of those bonds, and if we didn't pay them, they were going to foreclose on the land.

Q. As a matter of fact, do you know what the suit was? [125]

A. The suit was to foreclose.

Q. The Great Republic started foreclosure of the bonds?

A. Yes.

Q. Do you know of coupons that were presented to the county treasurer and weren't paid?

A. By the Great Republic Life?

Q. Yes.

A. Yes, they presented them.

Q. That is what happened, when they weren't paid——

A. I thought he meant, did I know of any in our particular family here, and I didn't.

Q. That is what happened, when the bonds

(Testimony of Robert R. Landrum.)

weren't paid, the whole issue was foreclosed. Is that right?      A. That is right.

Recross-Examination

By Mr. Crouter:

Q. Do you know of a long period of time prior to 1944, when, for some years, there were no payments, but there were no foreclosures?

Mr. Acet: That is immaterial. There were lots of time extended, your Honor, to everybody during the depression, and that doesn't indicate anything, any skullduggery.

The Court: The witness can answer if he knows what the answer is.

Mr. Crouter: What was the answer? [126]

The Witness: What was the question?

(The question was read.)

The Witness: Insofar as the Great Republic Life was concerned, they later liquidated or sold out to the Postal Union Life Insurance Company, and as soon as the Postal Union acquired the 86 bonds they were constantly demanding payment, which we kept stalling off from time to time. We did not have any money to buy them with at that time, so we kept stalling them off until finally they got impatient and sued us.

Q. (By Mr. Crouter): Mr. Landrum, please tell the Court whether it is a fact that between June 30, 1933, and about December 29, 1943, during that whole interval of time, from 1933 to that

(Testimony of Robert R. Landrum.)

date in 1942, there were no payments whatever made by the Birch Ranch and Oil Company to the county treasurer on these bonds.

A. On which bonds do you mean?

Q. On bonds outstanding of the Reclamation District No. 2035. Isn't that a fact?

Mr. Acret: That is objected to as argumentative. The Birch Ranch and Oil Company doesn't pay on the bonds. They pay the assessment of the county treasurer and the amounts, when he makes them.

Mr. Crouter: I will revise the question to make it as counsel suggested.

The Court: Restate the question then. [127]

Q. (By Mr. Crouter): Please tell the Court whether it is correct that during a period of several years between 1933 and late in 1943 no payments of any calls or assessments whatever were made by the Petitioner corporation to Mr. Cole, the county treasurer, or to any other county treasurer, on account of reclamation bonds.

A. I can't understand why there wasn't some payments made between 1933 and 1943. While I wasn't here in 1933, didn't come here until 1937, I can't answer that question accurately.

Q. Let's take the period when you were there. In 1937, up until the end, near the end of 1943, please tell the Court whether it is a fact that no payment whatever was made on any call or assessments of reclamation bonds by the Petitioner to the county treasurer.



(Testimony of Robert R. Landrum.)

A. No calls were made by the county treasurer.

Q. And no payments?

A. No payments were made—well, I say no payments were made on these calls, because no calls were made. Things were in bad shap at that time. The county treasurer wasn't making the calls. He was looking after the interests of the landowners, the same as a lot of other districts were doing, so he didn't make the calls. He wasn't forced to, I guess, so he didn't. [128]

Q. Was there any request by the Petitioner which was the reason for not making any call or assessment?

A. Not to my knowledge.

Q. Is that all you know about why it was not made, that you can tell the Court?

A. That is all I know.

Mr. Crouter: That is all.

Mr. Acret: I have some questions now that are quite pertinent, that counsel opened up.

### Redirect Examination

By Mr. Acret:

Q. Do you know whether or not the Birch Ranch and Oil Company purchased interest coupons when they became due from other landholders?

A. In '37, you mean?

Q. Any time between '37 and '44.

A. Yes, they purchased some, I think.

Q. Do you know whether or not they purchased the interest coupons on the bonds that were owned



(Testimony of Robert R. Landrum.)

by the Hopkins, when and as they became due?

A. Yes, that is true. They did.

Q. Do you know whether at any time the Hopkins ever permitted any of the coupons to become past due without you being required to purchase them?

A. No, they would never let them go past due.

Q. Isn't it a fact that all the coupons of these 786 bonds owned by the Hopkins during that period were purchased by the Birch Ranch and Oil Company when and as they became due? A. Yes.

Q. And isn't it a fact that in the preceding case, which Judge Turner sat as judge, that the amount you paid for those coupons was allowed as a deduction by him in that proceeding?

Mr. Crouter: If your Honor please, I object to that.

Mr. Acret: I withdraw the question.

The Court: The record will show that.

Mr. Acret: Yes, the record will show that.

Q. (By Mr. Acret): Is the same true with respect to bonds that were owned by Lula M. Minter?

Mr. Crouter: I object to that, in that it is shown by Judge Turner's findings and conclusions.

The Court: That would be the best evidence.

Mr. Acret: That wasn't the point of that question.

Q. (By Mr. Acret): I am asking you, were there other coupons on bonds owned by other bondholders that the Birch Ranch and Oil Company purchased when and as they became due?

(Testimony of Robert R. Landrum.)

A. We purchased Miss Minter's coupons.

Q. That is the interest coupons?

A. Yes. [130]

Q. Those coupons you turned in to the county treasurer?      A. Yes.

Q. And under Section 348, which provides they may be turned in as money?      A. Yes.

Q. Do you know whether or not the Birch Ranch and Oil Company is the largest landowner in Yolo County, or one of the largest landowners?

A. Yes, they are, they were.

Q. Do you know whether or not it is one of the largest taxpayers in Yolo County?

A. I don't know about the taxpayers.

Mr. Crouter: I object to that, unless counsel makes it more specific. If he refers to state real estate taxes, I object, in that it is immaterial and irrelevant.

Mr. Acret: Your Honor, it only goes to account for these letters from Mr. Cole, which, naturally, would be to a corporation that is one of the largest taxpayers, one of cooperation, which a county officer would do in a little county of that kind, and explanatory of those letters.

The Court: I don't know that is material to this. I sustain the objection.

Mr. Acret: Very well, your Honor. That is all of this witness.

Mr. Crouter: Just a moment. That calls for some [131] cross-examination.

Mr. Acret: I was going to ask the Court—we

(Testimony of Robert R. Landrum.)

won't be able to finish tonight, and did your Honor intend to continue until a later hour?

The Court: It is five o'clock. I think it is about adjournment hour. I would like to finish this witness before adjourning, because my experience is, if you bring a witness back, you start all over again and cover the same grounds.

Mr. Crouter: I have just a few questions.

### Recross-Examination

By Mr. Crouter:

Q. Referring to your recent testimony here, did I understand you to say that certain interest coupons were purchased from a Miss Minter?

A. Yes.

Q. You mean, the Petitioner corporation purchased the coupons?

A. In some cases we would buy her coupons and turn them in as cash, when no call was made. She got her money that way.

Q. And, you say, turned them in. Do you mean they were turned over to the treasurer in lieu of cash?

A. Yes. We would buy them from her and when he would make a call, we would turn them in for payment.

Mr. Acret: May it be stipulated, counsel, for the benefit of the Court, that Section 3480 provides that a landowner may purchase interest coupons of the bonds of the district and turn them in as cash?

(Testimony of Robert R. Landrum.)

Mr. Crouter: On that matter, it is my understanding the Court will take judicial notice of the state laws, and it will be included in the brief, and I would rather handle it in that way.

Mr. Acret: It would be helpful to the Court at this time.

Mr. Crouter: I haven't examined that statute carefully.

The Court: The Court will take judicial notice, but if the briefs will set that out so the Court won't have to make an examination.

Mr. Acret: What is your Honor's situation with regard to California statute. It is helpful to have them printed.

The Court: Our library contains it.

Mr. Acret: I had it printed the last time for Judge Turner and also the entire Hopkins contracts.

The Court: I think that would be helpful if it were furnished in the brief or stated in the record, so the Court could have access to it, if counsel for Respondent is not in disagreement.

Mr. Crouter: I will be glad to check with Mr. Acret [133] on that.

Q. (By Mr. Crouter): Mr. Landrum, referring to your testimony that the Birch Ranch and Oil Company purchased other coupons of bondholders, apparently when they became due, please tell me who these other holders of the bonds were and what the totals were.

(Testimony of Robert R. Landrum.)

A. We stated that we purchased the Hopkins sisters' coupons and Miss Minter.

Q. Can you tell the Court about the amounts involved there?

A. Miss Minter's amounted to—she had ten bonds, so sixty dollars a bond every six months, that would be six hundred dollars, I guess—no, it wouldn't be six hundred dollars a year; three hundred dollars every six months.

Q. Were any of the Minter bonds—any bonds outstanding that were held by Miss Minter during the fiscal year 1944, or was this done prior to 1944?

A. Yes, they were outstanding in 1944.

Q. Referring to other holders, the Hopkins sisters, what amounts of coupons were purchased by the Petitioner from them?

A. Theirs was changing from time to time, so I couldn't tell you off hand. When I came with Mr. Birch in 1937, they had three hundred, I believe, twenty-three thousand or twenty-four thousand dollars worth of bonds. He was buying them back [134] from time to time, so I couldn't tell you what it was in 1944.

Q. If my memory is correct, I believe the stipulated facts show at any time there were three hundred ten thousand dollars of bonds which were acquired by Mr. Birch from the Hopkins sisters, and as I understand the stipulated facts and your testimony, also, bonds were held by trustees pending further payment to the Hopkins sisters.

A. There was a certain number of bonds held



(Testimony of Robert R. Landrum.)

in trust as security for fulfillment of that agreement that the Hopkins sisters had with Mr. Birch, which was to purchase these bonds that they owned.

Q. When coupons were purchased, did the Petitioner purchase merely the coupon or would it purchase a bond with the coupon?

A. No. In most cases, it was always the coupons only on what they owned; not what was in the trust.

Q. Were those purchased usually for the full face value of the coupons? A. Yes.

Q. As I recall, you stated that there were 786 bonds which were outstanding at one point, apparently prior to 1944, and those were all purchased by Birch Ranch and Oil Company, the Petitioner, purchased by Mr. Birch individually?

A. 786?

Q. Yes. [135]

A. Of the Hopkins—I don't believe that is true.

Mr. Acret: I just didn't put this witness on the stand as to the ownership of the bonds.

Q. (By Mr. Crouter): As I recall, he testified there were 786 bonds outstanding, as purchased by Mr. Birch or the Petitioner?

A. No, sir; I didn't testify to that.

Mr. Acret: We are getting into deep water here that he doesn't know anything about, and Mr. Birch will testify to.

Mr. Crouter: I believe that is all.

Mr. Acret: That is all.

The Court: What about a session for tomorrow? Will it be agreeable with counsel, being Saturday?

Mr. Acret: It would with one exception, your Honor. I need to make a living out of cases other than this. I have a client that is coming in at eleven o'clock——

The Court: You have a client coming in at eleven o'clock?

Mr. Acret: Yes, your Honor, that is my understanding, and I might not get that case if I were not there.

The Court: How much time will it take, so we can estimate the amount of time. Of course, Mr. Birch will have to testify, and I guess his examination will be fully as long as Mr. Landrum's.

Mr. Acret: About the same time. [136]

The Court: We have consumed about three hours on this.

Mr. Acret: A half an hour, I would say, for Mr. Birch's testimony, as far as our direct examination is concerned, and maybe less. Mr. Landrum's was taken up by putting in the documents, which takes a little longer. There are no further documents, no further documentary evidence, that I can recall at this time.

The Court: What is Respondent's counsel's estimate as to time?

Mr. Crouter: If your Honor please, it would chiefly depend on what the Petitioner offers. I would say double the time they estimate for their direct would cover it.

The Court: If that took a half an hour, you would have an hour and a half?

Mr. Crouter: No, the cross-examination would be about the same time as their direct, as far as Respondent's case is concerned. I am glad to state at this time that Respondent will have nothing except some documentary evidence, as far as I know.

Mr. Acret: Concerning all of which we can probably stipulate.

The Court: Well, the Court wants to know about this question of a session tomorrow. Saturday ordinarily is not a day Court is held, and, of course, the Court is anxious to [137] finish this case. We have a case set Monday.

Mr. Crouter: I could be here, if the Court please, although it would disturb some private arrangements, but I can be here if the Court says, if the Court sees fit. I might say that the case scheduled for hearing on Monday, the attorney for the Respondent has advised me it will probably be about a one day case. Beyond that, I don't believe there are any cases for hearing.

The Court: No, the case for Tuesday, I understand, is likely to be settled.

Mr. Crouter: That is a probable settlement.

The Court: In view of everything, I guess we had better let this case go for Monday.

Mr. Crouter: I wonder if we could have it Tuesday?

The Court: Would Tuesday morning suit you better, in view of the fact that stont parties are out of town?

Mr. Crouter: Yes, they are down in San Diego and Arizona.

The Court: I think this case might go to Tuesday morning at ten o'clock, if that is agreeable. We can probably save time. In the meantime, counsel can be thinking about the shortcuts that can be taken.

Mr. Acret: Or more testimony, one or the other.

The Court: This case will be resumed, the trial of it, on Tuesday morning at ten o'clock. The Court will take [138] a recess now until Monday morning at ten o'clock.

(Whereupon, at 5:10 o'clock p.m., an adjournment was taken until ten o'clock a.m., Tuesday, February 15, 1949.)

Filed T.C.U.S. March 8, 1949. [139]

[Title of Tax Court and Cause.]

(Met pursuant to adjournment.)

Before: Luther A. Johnson,  
Judge.

Appearances:

GEORGE ACRET,

1210 Quinby Building,  
650 S. Grand Avenue,  
Los Angeles, California,

Appearing for the Petitioner.

EARL C. CROUTER,

(Honorable Charles Oliphant,  
Chief Counsel, Bureau of  
Internal Revenue)

Appearing for the Respondent.

## PROCEEDINGS

The Court: I believe we were to resume this morning the case of Birch Ranch & Oil Company.

The Clerk: Docket Number 8720, Birch Ranch & Oil Company.

Mr. Crouter: In this proceeding, if the Court please, so long as we are talking about the pleadings, you will recall there were certain amendments of the Petitioner, amended petition, in the Birch case, and Respondent has prepared the usual written answer to such amended petition, and I ask



leave to file this at this time so our pleadings will be complete.

The Court: That completes the pleadings for both sides, I believe.

Mr. Crouter: I believe that is so.

The Court: I believe Petitioner was engaged in introducing testimony, was he not, when we recessed?

Mr. Acret: Yes, your Honor. We are ready to proceed.

The Court: Call your first witness.

Mr. Acret: Take the stand, Mr. Birch. I don't believe he has been sworn.

The Court: The oath was administered last week with the other witnesses.

Whereupon, [142]

#### A. OTIS BIRCH

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

By Mr. Acret:

Q. You are the A. Otis Birch that is named in the stipulation of partial facts herein?

A. I am.

Q. From the time of the formation of the Birch Securities Company, that was about October, 1934, wasn't it?

A. The dissolution took place then.

(Testimony of A. Otis Birch.)

Q. No, I say the formation of the company was about October, 1934. Is that correct?

A. Yes, October 15, 1935.

Q. And you became the president at that time?

A. Yes.

Q. And continued as such up to September 30, 1944?

A. Yes.

Q. And the company kept its books on the basis of the fiscal year ending September 30th?

A. Yes, that was the close of the fiscal year.

Mr. Acret: By the way, counsel, could we put in at this time the income tax return for 1942?

Mr. Crouter: If counsel desires it at this time, Respondent will be glad to offer as Respondent's Exhibit next in the case the Birch Ranch & Oil Company income and declared value excess profits tax return form 1120 for the fiscal year ending September 30, 1942, this return having been filed in the Sixth California collection district.

Mr. Acret: I would like to have it as an exhibit also of this Petitioner, your Honor.

The Court: You want it as a joint exhibit?

Mr. Acret: Joint number.

The Court: Is that agreeable?

Mr. Crouter: I don't see any necessity for that, if the Court please.

Mr. Acret: We would like to have it as a reference number as one of our exhibits.

Mr. Crouter: That is agreeable.

The Court: What will be the number of the exhibit?

(Testimony of A. Otis Birch.)

The Clerk: It will be 13F.

The Court: 13F. That is the income tax return of the Petitioner corporation for the fiscal year 1942. Is that correct?

Mr. Crouter: That is correct, and I believe I had better call to counsel's attention that there may be a tentative return involved there. I don't know whether counsel is familiar with this.

Mr. Acret: Whatever counsel has, we don't want anything but the facts. Counsel calls my attention to the fact there is also a tentative return attached to it. We have no objection to it.

The Court: Both documents, I assume, will constitute that exhibit.

Mr. Crouter: Yes, sir.

Mr. Acret: It bears Mr. Birch's signature.

The Court: And the parties will be granted leave to substitute photostatic copies.

(The document above referred to was received in evidence and marked Joint Exhibit 13F.)

Mr. Acret: Inadvertently, starting in this morning here, looking at some papers, I referred to the Birch Securities Company in asking Mr. Birch the questions I asked. I intended to say, "Birch Ranch & Oil Company."

Q. (By Mr. Acret): It was the Birch Ranch & Oil Company that was incorporated in October, 1934? A. Yes.

Q. I meant to ask that. May it be understood

(Testimony of A. Otis Birch.)

that the question referred to the Birch Ranch & Oil Company?

You became president of the Birch Ranch & Oil Company at that time?      A. Yes.

Q. And remained such up to September 30, 1944?

A. I did.

Q. Do you know who owned the bonds of the Reclamation District during the year 1944, up to September 30, 1944?      A. Yes.

Q. Who did own those bonds?

Mr. Crouter: If your Honor please, I call for the record evidence on this. I believe that type of evidence should be reflected by writings, and I call for the best evidence on it.

Mr. Acret: Well, your Honor, that is not evidence——

The Court: I think that is a fact that can be shown, if the witness knows. I will overrule the objection.

The Witness: May I have the question?

(The question was read.)

The Court: If you know, you can testify, answer that. If you don't know, of course, say so.

The Witness: The Birch Securities Company owned 1,594,000 bonds and the Hopkins sisters owned par value of 310,000 bonds; Lula M. Minter owned 10 bonds, or ten thousand dollars.

The Court: A thousand each, par value?

The Witness: Par value of ten bonds, and the Birch Ranch & Oil Company owned 86,000 par value.

(Testimony of A. Otis Birch.)

Q. (By Mr. Acret): When did the Birch Ranch & Oil Company acquire those [146] eighty-six, and from whom?

A. It acquired them in 1940 from the Great Republic Life Insurance Company.

Q. Do you know how much they paid for those eighty-six bonds?

A. Sixty-five thousand dollars.

Q. That was less than the par value?

A. Yes.

Q. Was there ever any transaction other than that one, so far as you know, where those bonds were sold for less than par up to September 30, 1944?

A. No, there were none sold that I know of.

Mr. Acret: Your Honor and counsel, there is a stipulation with reference to the purchase by Mr. Birch of the ranch from the Hopkins, that is, the Hopkins' share of the ranch, and the Hopkins taking the purchase price in bonds at their face value, eighty-seven hundred eighty-six thousand. Then there is a contract concerning Mr. Birch's repurchase of those, and a stipulation that there was such a contract.

The Court: Repurchase of the bonds?

Mr. Acret: Repurchase of 786 bonds.

Q. (By Mr. Acret): By the way, Mr. Birch, you owned, before the incorporation of the Birch Ranch & Oil Company, we will say, just the day before October 13, 1934—do you know what the



(Testimony of A. Otis Birch.)

ownership [147] of those bonds was, of the reclamation district?      A. Yes.

Q. What was that ownership?

A. Mrs. Birch and I owned 1,594,000 and the Hopkins sisters 310,000; Lula Minter 10,000, and the Great Republic Life 86,000.

Q. Then, between 1925 and 1934, you purchased from the Hopkins the difference between 786 bonds and 310 bonds; is that right?

A. From the Hopkins?

Q. Yes.      A. Yes.

Q. What did you pay them for those bonds?

A. I paid them par value for them.

Q. As to whether or not you paid them interest, all accumulated interest on those bonds, up to October 15, 1934?

A. Yes, we paid them accumulated interest.

Q. Did you do the same as to the bonds, the remaining bonds owned by them, of the district?

A. Owned by Hopkins?

Q. Yes.      A. Yes.

Mr. Acret: In the case before Judge Turner, your Honor, we had the Hopkins' contracts in evidence. They are attached as an exhibit to the Petitioner's petition in that [148] case, Exhibits A and B. I offer those contracts in evidence herein by reference. I have the originals, but that is a printed petition; it is easy to read them, and I think that is the easiest and most effective way.

The Court: Without objection——

Mr. Crouter: If your Honor please, I would

(Testimony of A. Otis Birch.)

like to be heard on that. I don't believe that is a proper procedure, if your Honor please. I believe we should have, right in this record, and I would like to have for direct reference——

Mr. Acret: Well, I have them here. I offer the originals at this time, then.

The Court: What is it you offer?

Mr. Acret: The contract between A. Otis Birch and M. Estelle C. Birch.

Q. (By Mr. Acret): M. Estelle C. Birch is your wife? A. Yes.

Q. And was commencing along prior to 1920?

A. She was.

Q. And still is? A. Yes.

Mr. Crouter: What is the date of that?

Mr. Acret: Contract is dated January 10, 1925, and Louise Smith Hopkins.

Mr. Crouter: May I see the document? [149]

Mr. Acret: I will offer first the one dated January 1, 1924, Ruth Smith Hopkins.

The Court: Any objections?

Mr. Crouter: May I examine it just a moment, if your Honor please.

No objection.

The Court: That will be admitted then as Petitioner's Exhibit No.——

The Clerk: 14.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 14.)

(Testimony of A. Otis Birch.)

Q. (By Mr. Acret): Mr. Birch, I show you that just to refresh your recollection. You notice that is the 1924 one. Just notice the signatures at the end, and that will recall the contract to your recollection.

A. Yes, that is correct.

Q. Was a contract similar to that entered into with Louise Smith Hopkins?

A. It was identical.

Q. They were sisters? A. Yes.

The Court: The one offer was 1924 and now you are going to offer 1925? [150]

Mr. Acret: Yes, sir.

The Court: Same parties?

Mr. Acret: The one I am going to offer happens to be the other sister, I think.

The Court: There were two Hopkins sisters. One was named Ruth Hopkins and the other was Louise Smith Hopkins?

Mr. Acret: Yes.

Mr. Crouter: No objection.

The Court: The contracts between those parties mentioned, dated January 10, 1925, will be admitted as Petitioner's Exhibit No. 15. Is that correct?

The Clerk: Yes, sir. Exhibit No. 15.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 15.)

Q. (By Mr. Acret): This one, Mr. Birch, is between you and Mrs. Birch and Louise Smith Hopkins. Was there an identical one entered into at

(Testimony of A. Otis Birch.)

the same time, with the other sister, Ruth Smith Hopkins?      A. There was.

The Court: And also in 1924, was it, both sisters?

Mr. Acret: They were entered into at the same time, were they, all these contracts?

The Witness: Yes, the first one you showed was in [151] 1924, and this one, I believe, is 1925.

The Court: And there was a contract with each of the two sisters at each of those dates; is that right?

The Witness: That is correct.

The Court: The contracts were identical?

The Witness: Yes, sir.

Q. (By Mr. Acret): I now notice this bears the statement on it, "Cancelled. Louise Smith Hopkins. March, 1944." Was that contract delivered to the Birch Securities Company at the same time?      A. It was.

Q. Do you know, was it at that time that the Birch Securities Company bought the 310 bonds you mentioned from the Hopkins?

A. They finished the buying as of that date.

Q. And paid what price?      A. Par value.

Q. Did you likewise receive a contract of Ruth Smith Hopkins, received it back, marked cancelled, in the same way and at the same time?

A. We received the contract back but it wasn't marked, "cancelled."

Q. But it was intended to be?

A. Yes. It was paid in full.

(Testimony of A. Otis Birch.)

Mr. Acret: Now, for the Court's convenience, I will [152] state that those contracts are printed and they will be much easier to read in the petition, in the first case, and they are attached as exhibits to the petition. Also, I offer, by reference, in evidence, portions of what I referred to as the California Reclamation Act.

The Court: That is the state law of California?

Mr. Acret: Yes, your Honor, 3480. It is printed at page 128 of the appendix, filed in support of the Petitioner's opening brief in the former proceeding.

The Court: Any objections?

Mr. Crouter: If your Honor please, as to that, I do just object on formal grounds, if your Honor please. I have no objection if the Court wishes to refer to it in that manner, and it is shown as a correct copy of the state statute, but we can easily refer to the state statutes and Respondent will include that in the brief.

The Court: In other words, it is not necessary to encumber the documentary evidence any more than necessary. If counsel can agree to the state law of California, if that is set forth in the brief, or some way, so the Court can have the benefit of it, I would appreciate it.

Mr. Acret: The act is rather lengthy; naturally with the——

The Court: I mean, just those portions deemed pertinent here could be set forth. [153]

Mr. Crouter: With respect to the offer, if the Court please, that statute is fairly long, and in our



(Testimony of A. Otis Birch.)

briefs I would attempt to include only the portions that bear on the issues here. I have noticed there are several small subsections of that Reclamation Act, which have been reviewed. I do not know whether what counsel offers was all outstanding and in effect during the years or not.

The Court: The Court would like very much if counsel could agree as to what the law was in effect at that time.

Mr. Crouter: I would be glad to do that and include it with our brief.

Mr. Acet: Counsel and I seem to be able to reach an agreement on matters of that kind. I am sure there won't be anything standing in the way of our doing so. I just wanted to avoid the necessity of reprinting that.

The Court: You called attention of that excerpt attached to your other——

Mr. Acet: Yes, commencing at page 128 of the appendix to petitioner's opening brief in the former proceeding. Also, I have set up some additional portions that are pertinent to this proceeding in the Memorandum of Points and Authorities that I have filed herein.

Mr. Crouter: I object to the latter, if the Court please. It is not a factual presentation at all; it is just [154] a legal argument.

The Court: Yes, that won't go in as part of the evidence.

Mr. Acet: Well, that hasn't anything to do with

(Testimony of A. Otis Birch.)

the evidence at all. I am stating it for your Honor's convenience.

The Court: I understand counsel has done that for the convenience of the Court.

Q. (By Mr. Acret): Mr. Birch, you mentioned that the Birch Ranch & Oil Company purchased the 86 bonds from the Republic Life in 1940. Do you know how they tended to do that?

A. I didn't buy them direct of the Great Republic Life Insurance Company. The Great Republic Life Insurance Company was taken over by the Postal Union Insurance Company, and the Postal Union Insurance Company began an action in the District against the owners of the bonds for the collection of those 86 bonds, particularly the past due interest that hadn't been paid. Therefore, in order to protect the land in the district, we contracted with the Postal Union Insurance Company for the purchase, by giving a mortgage on some property we had.

Mr. Acret: I don't want to be in the position of going back on the stipulation, your Honor, but on page 13, my recollection is, I made a little check mark after it here, the bottom paragraph, counsel and I left open the question of the [155] correctness of that statement. I questioned it and it was to be subject to further investigation. I would like to ask Mr. Birch with regard to it.

Q. (By Mr. Acret): Mr. Birch, in the stipulation it says, "Beginning with 1937, and until 1943, no amount has been paid in any year by the peti-

(Testimony of A. Otis Birch.)

tioner as interest on the \$1,594,000.00 of such bonds transferred by Birch and his wife to the Birch Securities Company." Do you know whether or not that is correct?

A. Yes, I know, but it is not correct.

Q. In what respect is it not correct?

A. It seems to be the common expression that we pay interest into the county treasurer to pay the interest on the bonds, whereas the proper notation and entry would be that we pay the assessment that is levied by the district to meet the interest on the bonds.

Mr. Crouter: Before we leave that, if your Honor please, I object to that question and answer as not in accordance with the stipulated facts, and move they be stricken. Now, if the Court please, I believe the witness does make a distinction between the terminology to be applied to any payments, that is, whether they are interest or assessment or taxes upon the property. I am not too much concerned with terminology he may use, but I am concerned with the question [156] whether any amount was actually paid, any amount of money was paid to the county treasurer or to the Reclamation District. I take it, the effect of his testimony is that the payments were made.

Mr. Acret: He hasn't testified yet. I am coming to that. This is preliminary explanation.

The Court: The method of payment will be determined from the evidence, and as I understand,

(Testimony of A. Otis Birch.)

what the witness now is asked is with reference to the terminology of those expressions.

Mr. Acret: That is right, your Honor, and he is giving that preliminary explanation.

The Court: I understand counsel has no objection to that extent.

Q. (By Mr. Acret): That reminds me, Mr. Birch, you speak of the interest being paid on the Hopkins bonds. How was that done? What was the practice that was followed while you and Mrs. Birch owned the land of the district, that is, that part of the district comprising the ranch?

A. Well, for the first six years of the contract, beginning with 1925, the first payment was made to the Hopkins through their collection from the county treasurer of Yolo on the coupons that matured on the bonds. Then Mrs. Birch and I paid them \$78,600.00 annually as the redetermination or purchase of 6,600 par value of bonds.

Q. Well, how was the interest paid on the bonds? What was the procedure in this first six years?

A. Mrs. Birch and I paid the assessment, based on the call from the county treasurer, on the bonds, to provide for the interest payment, and the Hopkins cashed their coupons.

Q. You say that is the first six years. That would take it up to 1931. What was the practice followed by you and Mrs. Birch from 1931 to 1934?

A. We purchased the coupons from the Hopkins by paying them face value of the coupons as they matured.



(Testimony of A. Otis Birch.)

Q. The interest coupons, that is? A. Yes.

Q. What did you do with those coupons? Were they turned in to the county treasurer?

A. We deposited them with them.

Q. For what purpose?

A. To cash them when there would be money available.

Q. I mean, keeping in mind the provisions of the statute, for what purpose were they turned in, the same as money? A. Yes.

Q. Showing you Petitioner's Exhibit No. 10, is that the usual form of receipt received from the county treasurer on payment of either turning in coupons or turning in money? A. Yes. [158]

Q. That is referring to the second page of Exhibit 10, the first page being a check; is that correct?

A. Yes.

Q. Between 1925 and 1934—I believe it is in the stipulation that the deductions were made by Mr. and Mrs. Birch—did you make the deductions of the amounts paid to the county treasurer to meet interest on the bonds?

A. We did, always.

Q. When you and Mrs. Birch received back from the county treasurer such interest, did you take account for it as part of your income?

A. We did not.

Q. Why not?

A. Because it was tax exempt income.

Q. Do you know how many times that proce-



(Testimony of A. Otis Birch.)

quire, between 1925 and 1934, was questioned by the Commissioner?      A. Every year.

Q. Was that procedure ever disapproved during that period by the Commissioner?

A. No, not once.

Q. Was there any intention on your part in forming the Birch Ranch & Oil Company to in any way avoid taxes?      A. None whatever.

Q. Forming the two corporations, the Birch Ranch & Oil Company and the Birch Securities Company, was that to [159] enable you to be able, on the one hand, to deduct the amounts paid to the county treasurer to cover the interest on the bonds, and, on the other hand, to receive the interest from them without having it part of the income?

A. No, no more than when we owned the bonds personally, individually.

Q. Now, taking the next sentence on page 13 of the stipulation, referring to the Birch Securities Company, it says: "Nor has it paid any amount as interest on the \$86,000.00 of such bonds held by the Great Republic Life Insurance Company." That seems to refer not only to April, 1936, until April, 1943, but to all times, the way the stipulation is worded. What is the fact as to the payment of any assessments to meet interest?

A. My recollection is that assessment was paid in 1937, but subsequent to that, up until 1943, there were no payments.

Q. Why were there no payments?

A. Because we weren't able to raise any funds

(Testimony of A. Otis Birch.)

through our applications for loans through the Reconstruction Finance Corporation, and the various banks in the country.

Q. Well, is the answer, because you were unable to make the payment, didn't have the money?

A. Didn't have the money and couldn't borrow any.

The Court: Was the depression period still on at this time? Did that have anything to do with your condition? [160]

The Witness: Yes, that was.

The Court: The depression which began in '29?

The Witness: Yes, but we didn't feel the pinch until about '31 or 2.

Mr. Acret: The depression really hit out on the coast about the middle of 1933. It drifted out here as a wave. Our bank blew up in March, 1933, is my recollection.

The Witness: I might add that the bank that we had our account at in Sacramento failed and tied up our funds there, besides we owed them——

The Court: When did that occur?

The Witness: That was in 1931 or 2.

Mr. Acret: I guess the record shows all assessments were paid on the bonds, all assessments of the Reclamation District were paid during the fiscal year ending September 30, 1944.

Q. (By Mr. Acret): They were paid right up to date, weren't they, all the assessments of the district?

Mr. Crouter: If your Honor please, I have no

(Testimony of A. Otis Birch.)

objection to that insofar as it calls for the payment of money, but I do object to any conclusions as to whether it was an assessment, and so forth. I believe what counsel seeks is really shown by the record.

The Court: Isn't that contained in the stipulation? [161]

Mr. Crouter: No, that is not covered by the stipulation, but I think everything counsel seeks to establish is covered by record evidence, such as the checks.

The Court: Of course, if it is already in evidence, it wouldn't be necessary.

Mr. Acret: What bothers me a little bit is the way counsel drew up the stipulation. He calls it all the way through "payments of interest," and that is only a matter of nomenclature, and the evidence would show what the facts were.

The Court: You want to offer evidence to sustain your contention that it was not interest?

Mr. Acret: In other words, it is whatever it is by reason of the law.

Mr. Crouter: That is part of the basis of my objection, if the Court please. It does call for a conclusion and we will probably be arguing about that until our last brief is filed.

The Court: The witness can't establish a conclusion of law. He can state the facts as he understands them.

Mr. Acret: Nevertheless, I have to embody in

(Testimony of A. Otis Birch.)

my question and frame the question properly as I understand to be the effect of the law.

May I have the question read?

(The question was read.)

Mr. Crouter: I object further; leading and [162] suggestive and improper direct examination.

Mr. Acret: I withdraw the question.

Q. (By Mr. Acret): Mr. Birch, do you know whether or not there were any payments that were due the district to meet interest on the bonds accruing during the fiscal year ending September 30, 1944, that were unpaid?

A. I can't recall that there were any that were not paid.

Q. In other words, by 1944 your companies were in a little different financial shape, and able to take care of the various obligations?

A. Yes. We had sold some properties that provided some cash, and we were able to make some loans then, and had liquidated some of the other indebtedness to various creditors, something over a million dollars.

Q. That reminds me, Mr. Birch, one other matter that was left open in the stipulation, your Honor, and I want counsel to understand I don't want to be in the position in any way of going back on the stipulation, but I think this was left open also.

I call your attention to this paragraph on page 12 of the stipulation, Mr. Birch. I direct your attention to it, and read as follows: "On October 15,

(Testimony of A. Otis Birch.)

1934, Birch and his wife organized Birch Ranch & Oil Company, the Petitioner herein, [163] and transferred to it the Conaway Ranch, their interest in the Birch Oil Company, the partnership of which succeeded the Menges Oil Company in 1911, and all other property belonging to them, except the bonds of Reclamation District No. 2035, certain corporate stock and other properties having a value of about \$600,000.00."

This property you kept out, property having a value of about \$600,000.00, did you have any purpose in keeping that out and not transferring it to the corporations?           A. Yes.

Q. What was that purpose?

A. That was to protect the other creditors.

Q. Your personal creditors?           A. Yes.

Q. That is so you and Mrs. Birch would still have some personal assets?           A. Yes.

Q. Passing on to this next page——

The Court: You are referring now to an extract you are going to read from the stipulation of facts?

Mr. Acet: Yes, your Honor.

The Court: I think it might be well to indicate when you begin and when you end, when you are reading.

Mr. Acet: Very well, your Honor.

Q. (By Mr. Acet): That property that you held out, was that ever any—was any part of that ever transferred to the Birch Ranch & Oil Company or the Birch Securities Company or the Birch Holding Company?



(Testimony of A. Otis Birch.)

The Court: That is the \$600,000.00?

Mr. Acret: Yes, sir.

Q. (By Mr. Acret): The \$600,000.00 property, was any of that transferred to these corporations?

A. No.

Q. What is it? A. I believe not.

Q. Now, Mr. Birch, in the stipulation on page 14, it reads as follows: "On its books for the fiscal years 1937 and 1939, the taxable years herein, the Petitioner accrued \$120,000.00 to represent some on the entire \$2,000,000.00 par value of issued bonds of Reclamation District No. 2035." Is that a correct statement. Is that statement strictly correct, to represent interest? A. No.

Mr. Crouter: I must object to this on the same grounds, that this is a matter for the Court's determination, under our Revenue Act, and under the state law.

The Court: Counsel is asking the witness what he understood the payment was for. [165]

Q. (By Mr. Acret): What was your understanding that was for, this accrued \$120,000.00?

A. Well, the interest of \$120,000.00 accrued on the bonds and assessment was levied on the land to provide for the same amount of money by issuing a call by the treasurer of Yolo County.

Q. Was the \$120,000.00 accrued to meet that expected call?

A. The interest had accrued and they made the call through the district.

(Testimony of A. Otis Birch.)

Q. I say, was the amount of \$120,000.00 accrued on the books to meet that call?

A. Yes, it was on an accrued basis.

Q. Now, it says here, on page 14——

The Court: Is it the stipulation you are reading now?

Mr. Acret: Yes, your Honor.

Q. (By Mr. Acret): “For the fiscal year 1937,” and I want you to listen to this, Mr. Birch, “it entered the \$18,600.00 paid to the Hopkins sisters, as above stated, as a loan to the Birch Securities Company.”

Do you know how that happened to be put on the books that way? [166]

Mr. Crouter: If your Honor please, I think I will have to object to that. I thought we had reduced these things to final form. If we are going into the books and records, I call for the best evidence, and this is a little bit afield from our main point. I did not know counsel wished to go into these matters. I call for the best evidence, the books and records, and so forth, so we can see exactly what the documents are. I object to establishing those things by oral testimony or trying to.

Mr. Acret: Your Honor, we have stipulated the best evidence. That is the facts. They accrued those on the books in that manner, and I want to show it is a mistake, who made the mistake, and what was done with it.

The Court: In other words, you want to show the book entry was in error?

(Testimony of A. Otis Birch.)

Mr. Acret: The accountant made the error.

The Court: The stipulation contains the fact that the book entry was so and so, and you want to show it, as I understand it, that it was an erroneous entry.

Mr. Acret: That is right.

The Court: If there is any controversy about the existence of that matter, or just a mere proof of what it was——

Mr. Crouter: I have no objection to a mere explanation by the witness of the stipulated facts. I thought counsel was seeking to establish something else. [167]

The Court: No, he is simply trying to stipulate what his understanding was.

Mr. Acret: I won't seek to establish anything different from the stipulation, except in the places counsel and I reserved, and this is in one of them.

Q. (By Mr. Acret): Do you know how that came to be entered in the books that way for 1937?

A. Yes.

Q. What was it?

A. We had employed a bookkeeper to open up the corporation books, and he interpreted that payment as a payment of interest, rather than a payment of assessment, and he treated the payment to the Hopkins as paying them interest on our obligations under the contract, rather than paying the assessment so that the Hopkins could cash the coupons that matured at that time.

Q. When did you first discover that was entered that way?

(Testimony of A. Otis Birch.)

A. When the question was raised by a field agent of the Federal government.

Q. What was done about it in subsequent years, with respect to the amounts paid to the district to meet interest on the bonds? Were they entered in that manner or in a different manner? [168]

Mr. Crouter: If your Honor, please, I object to evidence of this character. That certainly should be shown by some books and records. It has been apparent in this case, up to now, we have no original books or records reflecting any of these payments.

The Court: Any controversy about that?

Mr. Acret: If there is any controversy about that, I don't know—counsel had it before.

Mr. Crouter: I call for the best evidence, if the Court please. We are working in the dark, talking about books and records, and trying to establish it by oral testimony.

Mr. Acret: As a matter of fact, I don't think it makes any difference.

Mr. Crouter: Then I object, because it is immaterial.

Mr. Acret: Don't interrupt me, please, counsel.

Mr. Crouter: I am forced to.

Mr. Acret: Let me finish before you are forced to. As a matter of fact, I don't think it makes any difference, your Honor, because in the income tax returns for the year in question, the item is deducted as taxes paid, and that, coupled with the deficiency assessment, gives all the facts and leaves



(Testimony of A. Otis Birch.)

it, as a matter of fact, to just the legal conclusions to be derived therefrom. It is the same situation all over again. I don't think there is any matter of accounting involved here. I don't think there is any fact in this case, [169] your Honor, and counsel, that is or should be in dispute. It is simply a matter of legal question, of interpreting the Reclamation Act.

Mr. Crouter: What Mr. Acret recently said is part of the basis for my objection, if the Court please. His question appeared to me to be going into what is shown by books and records as separate and apart from what is shown by tax returns, and so forth. It seems to me the facts which would be necessary for the Court's determination of what those payments may have constituted are already in the record. My objection was chiefly to going into books and records and saying how they were shown and charged and listed.

The Court: Since the testimony of the witness, the point at which the books were entered to show payments of entry only and having been understood between counsel that was a matter that could be stipulated or explained by oral testimony, as to how that occurred, and then counsel followed that in his explanation to show that error did not occur again, I think that is all right. I don't think it calls for the necessity of books, if the witness knows that did not so occur again in the books.

Mr. Acret: That is the only thing that brought the subject up at all, was that correction.



(Testimony of A. Otis Birch.)

Q. (By Mr. Acet): Mr. Birch, in participating as one of the landowners [170] in the formation of Reclamation District No. 2035, did you or your associates have any intention of tax avoidance?

A. No, it never occurred to us.

Q. And you and your wife and Mr. and Mrs. Conaway spent in performing the contract for the improvement of the district, as stated in the stipulation, an amount equal to or in excess of two million dollars?

A. Yes.

Q. For which you received the warrant that is in evidence or that is referred to in the stipulation, the two million dollar warrant?

A. That is correct.

Q. As stated in the stipulation, an election was held to promote a bond issue against the district to pay the warrant?

A. Yes.

Q. As one of the landowners, did you participate in the proceedings for it, in the election for the bond issuance?

A. I didn't quite get that.

Q. Did you, as one of the landowners in the reclamation district, participate in the election relating to the bond issuance?

A. We did.

Q. Did you in any way have any intention of tax avoidance in connection with that matter?

A. None whatever. [171]

Q. How long was it that you waited for your money for the work that you and Mr. Conaway did in improving the district from the time of the commencement of the work until the time that you got the money or the bonds in payment therefor?

(Testimony of A. Otis Birch.)

A. About six or seven years.

Q. During that time, as the work was performed, did you make any effort to get warrants to pay you up to date?

A. No. That was the common practice in other districts, but the Birch Oil Company, as a contractor, might have presented statements monthly for the work performed, and the district, in that event, would issue you a warrant, representing the amount involved. The contractor then, as the ordinary common practice, would present that warrant to the county treasurer to cash it. If there were no funds on hand to cover it, he would stamp it, "No funds available," and from that day on it would draw seven per cent. If we had done that monthly for the first six or seven years, we would have accumulated several thousand dollars more earning. Then there would have been a greater bond issue to cover the entire expense.

Q. As a matter of fact, the state engineers estimate was some two million two hundred odd thousands, was it not, for the construction costs in the district?      A. Yes.

Q. And you only took the one two million dollar warrant?

A. That is right, after the work was completed.

Q. You didn't avail yourselves of the seven per cent interest?      A. Not at all.

Q. Which would have an additional basis of tax deduction?

(Testimony of A. Otis Birch.)

Mr. Crouter: I object to that, on the ground it calls for a conclusion.

Mr. Acret: That is argumentative.

The Court: Argumentative.

Mr. Acret: Lawyers sometimes like to put a point over. Sometimes it is irresistible. I think that indicates I have just about covered the subject.

The Court: I think so. Let's take a ten minute recess.

(Short recess taken.)

The Court: The witness will resume the stand.

Mr. Acret: Counsel may cross-examine.

### Cross-Examination

By Mr. Crouter:

Q. Referring to your testimony, Mr. Birch, about who owned the bonds of the reclamation district, we have been talking about, during the fiscal year 1944, is there any written record that you have available here so that you can show the Court exactly who the owners were with respect to any bonds during the fiscal year 1944?

A. No, I haven't any memorandums. [173]

Q. Is there any stock record book or certificate book of any reclamation district, that you have here in the court room?

Mr. Acret: Just a moment. Your Honor, counsel overlooks the fact that Reclamation District is a state agency, the offices of which are up in northern California. How would we be expected

(Testimony of A. Otis Birch.)

to have any records of the reclamation district?

Mr. Crouter: I am asking Mr. Birch.

The Court: Counsel asked him if he had it and he said he didn't, as I understand it.

Q. (By Mr. Crouter): Mr. Birch, please tell the Court from the very inception of any Reclamation District 2035, about 1925, what, if any, official position you held in the reclamation district. Just tell the Court year by year as to that, as that went along, what, if any, officer you were of the reclamation district, clear down through the year 1944.

A. You mean, when it was organized, back in 1919 to 1944?

Q. Whenever it was first organized.

A. It was organized in 1919. The petition was made in 1918.

Q. Well, the reclamation district, as such, did not really start until 1925?

A. No, sir. That was the date the bonds were issued, [174] after the work had been performed.

Q. Were you an officer of any Reclamation District 2035 between 1925 and the end of 1944?

A. I believe not.

Q. You never were?

A. No. I might have been in the early part, but not to my recollection after the bonds were issued.

Q. You were never a trustee of the district at any time?

A. I was, I say, for a time, but my recollection

(Testimony of A. Otis Birch.)

is not after the bonds were issued. I wasn't one of the trustees on its organization.

Mr. Acret: Did he say he was not?

The Witness: I was not. The supervisors appoint the trustees, and I wasn't one of them.

Q. (By Mr. Crouter): Well, now, Mr. Birch, there is in evidence in this case, Exhibit 8—

Mr. Acret: May it be understood the supervisors to whom he refers, so it won't have to be picked up on further examination.

The Court: Who are the supervisors, the directors of the district?

The Witness: The county supervisors appoint the trustees of the district.

The Court: All right. [175]

Q. (By Mr. Crouter): Did you ever have anything to do with the election or designation of any trustee?

A. I might have suggested my father-in-law to be a trustee.

Q. That was Mr. Conaway? A. Yes.

Q. You suggested Mr. Armfield, also, your lawyer, did you not? A. Not I, personally.

Q. You never did?

A. No, I didn't personally. Mr. Conaway was up there.

Mr. Acret: I object to counsel saying "his lawyer, personally." Mr. Armfield was lawyer for the reclamation district, a lawyer, and a local banker up there.



(Testimony of A. Otis Birch.)

Mr. Crouter: He answered the question.

Q. (By Mr. Crouter): I proceed with the matter I started on a moment ago, and show you Exhibit 8 in evidence. This seems to be a cancelled original or sample of bond number 2,000 for \$1,000.00 and a notation on the margin reads "Cancelled on exchange for refunding bond number R-2,000, Roy E. Cole, treasurer, Yolo County."

Now, this seems to be the last of a first series of bonds, is that correct, number 2,000. Is that the way it [176] operated?

A. Yes, to the best of my knowledge, there were two thousand bonds, and it was numbered 2,000. It must be the last one.

Q. You will notice that this carries a date of 1925 in here, January 1, 1925, being on the very last line, apparently being an issuance date.

A. If that is the issuance date, that is correct.

Q. Now, the thing I'm getting to, Mr. Birch, do you have here in the court room any original or exact copy of any reissued bond that you could show the Court and show me, so I can see how it reads?

Mr. Acret: Just a moment. That is objected to as immaterial. We have the certified copy of the record of the Superior Court, validating the first bond issue and validating the second bond issue, each of which contains a certified copy of the bonds of issue. It is objected to. To go into this is encumbering the record.

The Court: The record already contains the exact copies, as I understand. Is that right?

(Testimony of A. Otis Birch.)

Mr. Crouter: I disagree with that, if the Court please. The record shows certain proceedings way back in 1935, and they relate to what may have been authorized to be done, but they do not show by any court order entered in 1935 what was done as of a later date, and particularly whether any bonds [177] were issued and outstanding during the fiscal year 1944.

The Court: Were there any bonds issued subsequent to 1935?

Mr. Crouter: I would like to know from the witness.

The Court: Were there?

The Witness: Yes, the bonds were twenty-year bonds, a serial commencing maturity ten per cent in 1935. At that time we held another election for authorization of refunding bonds, and it was completed and those bonds were issued and they ran until 1945. Preceding that, about two years, we had given an option for the sale of the bonds and the ranch, and the option holders carried on the refunding again, and, of course, both of those first two refunding bonds were surrendered to the county for the last refunding bonds, which were dated 1945.

The Court: What particular bonds were referred to in the validating order of the Court?

Mr. Acret: Both proceedings, your Honor, the proceeding validating the first series of bonds, and then there was a proceeding validating the second series.

(Testimony of A. Otis Birch.)

The Court: By "second," you mean the refunding bonds?

Mr. Acret: Refunding bonds, and Mr. Landrum testified that the old bonds were turned in and the refunding bonds were issued in place of them, and the Birch Securities Company [178] received its share, that one million five hundred ninety-four thousand dollars.

The Court: Does it show bonds that were issued in lieu of these original bonds? Does the record contain any record of those bonds?

Mr. Acret: Mr. Landrum testified he received the bonds referred to in that record of the Superior Court. I don't know what the exhibit number is, but the copy of the bond is set up and Mr. Landrum identified it.

Mr. Crouter: If your Honor please, I merely want to pick up the story from Mr. Landrum. Your Honor will recall I asked Mr. Landrum certain questions, and I got the response, "Mr. Birch knows all about that and he will testify to it."

Mr. Acret: I wish counsel would be accurate and quote my words. I didn't say "Mr. Birch knows all about anything," because he doesn't, and neither do I, and neither does counsel. I said I didn't put Mr. Landrum on to testify as to the ownership of the bonds, but that I would put Mr. Birch on.

The Court: As I understand, Mr. Birch was to know all about the ownership of the bonds.

Mr. Acret: And he so testified.

(Testimony of A. Otis Birch.)

The Court: I don't know what the line of questioning counsel now is seeking, but we will go ahead and see what it is. I don't want to go back. In other words, this case has [179] already assumed pretty wide proportions, having been tried before two other judges. So, I don't want to go back over any beaten path and introduce any evidence already contained in the stipulation of facts or exhibits that have been offered. What was the question now?

Q. (By Mr. Crouter): I would like to ask, if the Court please, and I ask Mr. Birch, what, if any, written evidence do you have of any reissued bonds that were issued after or in connection with the reissuance indicated by Exhibit 8. In other words, do you have any copy of any bonds that were outstanding, so I can see the exact provision?

The Court: You mean, in Court now?

Mr. Crouter: Yes, anything that was outstanding during 1944.

The Witness: I haven't anything. All of the bonds representing any one issue would be on deposit with the county treasurer of Yolo County.

Q. (By Mr. Crouter): Referring to your testimony that an option was given to purchase, did you say the lands and the outstanding bonds?

A. Yes, sir.

Q. What was the date of that option?

A. About '43, in March, I believe. [180]

Q. Do you have a copy of any documents relating to that matter?

A. Not with me, no.

Q. Was that an option to some other corpora-



(Testimony of A. Otis Birch.)

tion or person besides you and Birch Ranch & Oil Company?

A. Oh, yes, it ran to Mr. Rasmussen, and he sold it eventually to other individuals, who incorporated when they purchased it.

Q. Was he connected with Woodland Farms, Incorporated?

A. I believe so, and also the Con Ranch was another one.

Q. That date was March, 1943?

A. That was 1943. My recollection is that it was either February or March of 1943.

Q. I take it that was a written document of some kind?

A. Yes.

Q. Written option?

A. Yes.

Q. And a written agreement?

A. Yes.

Q. Was Birch Ranch & Oil a party to the agreement?

A. In selling the ranch and the land, yes, as a personal property.

Q. Were you and Mrs. Birch parties to the agreement in selling bonds?

A. Yes. [181]

Q. You don't have a copy of any of those documents relating to the transaction with Mr. Rasmussen or Woodland Farms, Inc.

A. I haven't it with me.

Q. Please tell the Court what, if anything, was done with the bonds that were outstanding and held by you and Mrs. Birch at the time, in March, 1943, when that agreement was entered into.

Mr. Acet: That is objected to as not in ac-



(Testimony of A. Otis Birch.)

cordance with the evidence. He didn't say "agreement." He said "option."

Q. (By Mr. Crouter): When the option was entered into?

A. What is the question now? What became of the bonds?

Mr. Acret: Objection. Also, if your Honor please, the question is assuming something not in evidence. The bonds owned by Mr. and Mrs. Birch, the testimony is that the bonds are not owned by Mr. and Mrs. Birch. They were otherwise owned at that time, and I presume this is speaking for the fiscal year ending 1944, up to the fiscal year ending 1944.

The Court: What fiscal year does he have reference to, any particular fiscal year? The Court inquires of counsel.

Mr. Crouter: I will withdraw the pending question and start further back, if the Court please.

Q. (By Mr. Crouter): You mentioned the Birch Securities Company, and I will ask you whether it is not a fact that the Birch Securities Company was suspended from doing business in California sometime in 1938?

A. Yes.

Q. How long did it stay suspended, according to your own knowledge?

A. Until it was disincorporated.

Q. When was that?

Mr. Acret: That is objected to as immaterial, unless it was before September 30, 1944.

Mr. Crouter: If your Honor please, I would like——

(Testimony of A. Otis Birch.)

The Court: I will overrule the objection. We will see what he is getting to. Answer the question.

Q. (By Mr. Crouter): The question is when it was disincorporated or when it was dissolved?

A. I don't know what the——

Q. Do you know when, if at any time, the Birch Securities Company was dissolved?

A. It completed dissolution in October of 1944.

Q. Did it ever do business at all between 1938 and 1944, that is, Birch Securities Company?

A. I wouldn't say that it did any business. [183]

Q. Do I understand your testimony from the prior occasion here to be that during some portion of the time, before the end of 1944 or the end of the fiscal year 1944, the Birch Securities Company held the stock of the Birch Ranch & Oil Company. That is the way it was held for a long time, isn't it?

A. No. The Birch Securities Company never did hold the stock of the Birch Ranch & Oil Company.

Q. Then, it was the Birch Holding Company that held the stock directly? A. Yes.

Q. Then you and Mrs. Birch owned all the stock of the Birch Holding Company?

A. That is correct.

Q. Now, did the Birch Securities Company, during any of the years between 1938 and 1944, have issued to it, or did it actually hold any of these reclamation bonds? A. Yes.

Q. Which way were they handled? Were they bearer bonds?

(Testimony of A. Otis Birch.)

Mr. Acret: What?

Mr. Crouter: Bearer bonds, issued to bearer without the name of the holder.

The Witness: They didn't read "bearer" but they were negotiable. [184]

Q. (By Mr. Crouter): Tell the Court how any bonds were held by the Birch Securities Company during that period I have indicated and what amount of bonds, if you know.

A. The time they were incorporated in 1934, Birch Securities Company received \$1,594,000.00 in bonds.

Q. How long did the Birch Securities Company hold those bonds, if you know?

A. Until it was dissolved.

Q. What happened then with the bonds, in October, 1944?

Mr. Acret: Your Honor, I object to that as being immaterial. We will open up a field here that is outside and beyond the fiscal year that is in question here, and we ought to keep to the issues.

Mr. Crouter: Yes, I withdraw that. I was thinking of the calendar year there for a moment.

Q. (By Mr. Crouter): Please tell the Court whether it is a fact that during all of the fiscal year 1944 the Birch Securities Company was suspended from doing any business, by Court order, directed not to do any business under order of the Court?

Mr. Acret: Just a moment, please. That is objected to as assuming something not in evidence and not in accordance with law. Under the law of

(Testimony of A. Otis Birch.)

California, no company suspended by Court order purports to be suspended on request of the [185] Franchise Tax Commissioner by the Secretary of State.

The Court: Well, the witness can state what facts he knows. The legal effect of what the order is, probably the witness wouldn't be familiar to testify. He might not be qualified to know what the effect might be.

Mr. Crouter: I withdraw the question.

Q. (By Mr. Crouter): What, if any, investigation was pending during the fiscal year 1944, involving Birch Securities Company?

A. The state was attempting to collect about nine thousand dollars.

Q. Was it on that account that there were certain legal proceedings involving the question of doing business by Birch Securities Company?

A. No, not out of that, but from the fact the Birch Securities Company previously received the interest on the coupons that it held, and it treated that as an income.

Q. Do I understand that the State of California was seeking to impose some tax on Birch Securities Company?      A. Yes.

Q. And then the Birch Securities Company just ceased to have any transactions of that kind, pending a clarification of that in the Courts. Was that the situation?

A. I don't know that was the result. We didn't



(Testimony of A. Otis Birch.)

have the money to pay any taxes; therefore, they haven't anything to [186] collect.

Q. Do you have any books or records here of Birch Ranch & Oil Company reflecting any account relating to payment of money to the county treasurer with respect to reclamation bonds?

A. No, I haven't any books.

Q. Were there any such books or records kept?

Mr. Acret: That is objected to as cumulative, your Honor. We have the original evidence here, and that is the return, certified checks, with the county treasurer's receipt for all the payments that are material to this proceeding, to wit, all the payments made to the Reclamation District during the fiscal year ending 1944, and you couldn't ask for more than that. There is the checks totaling \$221,000.00. Why go outside of those?

Mr. Crouter: I submit, if the Court please, it is a proper question, and I would like to have it answered.

The Court: The reporter will read the question.

(The question was read.)

The Court: Answer the question. Were there any such books kept?

The Witness: I didn't keep any book personally for the bonds I owned, when I owned them. There was some entry in the books of when the Birch Securities Company was organized, and also when the Birch Ranch & Oil Company bought those 86 bonds from the Postal Union. It made an entry



(Testimony of A. Otis Birch.)

of the ownership [187] of the ownership bonds.

Q. (By Mr. Crouter): Mr. Birch, my question is whether Birch Ranch & Oil Company, a corporation, kept any permanent records or books reflecting any payments of money to the county treasurer during the fiscal year 1944, such as the amounts shown by the exhibits 9, 10, 11 and 12 in evidence and before you?

A. Yes, our bookkeeper would make those entries on the Birch Ranch & Oil Company books.

Q. Where was the office of the Birch Ranch & Oil Company, if it had any, during the fiscal year 1944?

A. In the Auditorium Building, on the fifth floor.

Q. Where was it located?

A. Auditorium Building, on the fifth floor, Los Angeles, Fifth and Olive Streets.

Q. Does it still have an office there?

A. Yes.

Q. Are those records still kept? A. Yes.

Q. And that is approximately a mile from the Federal Building, where we are holding this hearing, isn't it? A. What?

Mr. Acet: If counsel wants those books and there is the slightest question about it, we will have them here, but it is purely cumulative. We have the original payments and [188] receipts. If your Honor feels that it is in any way clarifying, we will have them here, and chances are, I would say, probably in fifteen minutes. That is how easy it is.

The Court: There is an offer made to produce

(Testimony of A. Otis Birch.)

the books, as I understand it, by Petitioner's counsel.

Mr. Acret: It is objected to, however, as being cumulative and unnecessary. The best evidence is already in on those payments.

Mr. Crouter: This bears upon another matter I will refer to.

Q. (By Mr. Crouter): The office, then, is about a mile from the Federal Building. Is that correct?

A. Not more than a mile.

Q. Now, Mr. Birch, have you kept any permanent record of your own with respect to any of the amounts received by you and Mrs. Birch from the county treasurer, which was regarded by you, as I recall your testimony, as tax exempt?

A. I never kept any books personally.

Q. Do you have any complete record of that?

A. Only my checkbooks, bankbooks, evidencing the deposits.

Q. Showing deposits of such money?

A. Yes.

Q. Referring to your testimony about the length of time [189] that the payments were made to the Reclamation District, there was a period of several years when they were not made, and I believe you stated that was because of the depression years, and not having money available?

A. That is correct.

Q. Was that the only reason?                      A. Yes.

Q. Now, during those years, when those payments were made by the Birch Ranch & Oil Com-

(Testimony of A. Otis Birch.)

pany to the county treasurer, did I understand you to say that any persons, including yourself, who owned bonds, still collected this tax exempt interest from the county treasurer?

A. No, they didn't collect it from the county treasurer.

Q. So that if the record——

A. ——they collected—their interest would be that we would buy the coupons from the bondholders.

Q. By "we" do you mean you, individually, or the corporation, Birch Ranch & Oil?

Mr. Acret: That is objected to as not clear as to which year is being talked about.

Q. (By Mr. Crouter): Please tell counsel which year you are talking about and who do you mean by "we."

Mr. Acret: I asked counsel to tell the witness which year he is talking about. [190]

The Court: I don't remember just what the question was. What year did you understand you were testifying about?

The Witness: I understood I was testifying during the period which the assessments were not paid in to the county treasurer.

Q. (By Mr. Crouter): And that was roughly from sometime in 1937 down to the latter part of the calendar year 1943, was it not? A. Yes.

Q. During that period, the coupons were purchased by whom?

A. Either the Birch Ranch & Oil Company or

(Testimony of A. Otis Birch.)

personally by the individuals. The Birch Ranch & Oil Company, after 1934, guaranteed the contract with the Hopkins, and when the Hopkins were assisting on either the payments or six months extension through this guarantee of the Birch Ranch & Oil Company, and to satisfy them, for them to consent to an extension of a six months period at a time, we would purchase the coupons from them and pay them face value for them, \$30.00 a coupon.

Q. You say there was a guarantee. Was that in writing? A. Yes.

Q. Do you have a copy of that available, or original?

A. I believe that is included in the Hopkins extension agreement. [191]

Q. One of the documents offered this morning?

A. Well, I don't know what document that is, but my recollection is that it was all embodied in one agreement.

Q. I want to find out whether we have it in the record here. I show you Exhibits 14 and 15. Do you refer to either of these as the extension agreement, or do you refer to some other document, as that seems to be an original agreement, isn't it? That is what year, 1924, 1925? That was an original agreement? Not an extension. That was after 1943.

Mr. Acet: There is not anything that can be misunderstood. For that reason, I do not hesitate to speak up. I offer to stipulate with counsel that

(Testimony of A. Otis Birch.)

from year to year various extension agreements were entered into between Mr. and Mrs. Birch and the Hopkins, up to 1934, extending the time to meet the contracts which are in evidence here, and thereafter extension agreements were entered into by the corporation with the Hopkins.

Mr. Crouter: Mr. Acret, I am not able to stipulate that to you, because, as you know, I do not have copies of such documents. I do not know what the facts are. I am attempting to establish the facts. I appreciate your offer nevertheless.

Mr. Acret: I think they are in evidence as exhibits.

The Court: If counsel knows whether they are in evidence, indicate now what it is, so we can save time. [192]

Mr. Acret: Counsel was one of the attorneys in the other case.

The Court: If either counsel is sure such documents are in the record now——

Mr. Acret: I know we had them in Court.

Mr. Crouter: I don't believe they are in evidence in this case.

Mr. Acret: No, but I think they were in the other case, or were available for counsel's inspection in the other case. I remember that.

Q. (By Mr. Crouter): Mr. Birch, will you please tell the Court under this option, which was given about March, 1943, what, if any, provisions the option contained as to who would own the bonds



(Testimony of A. Otis Birch.)

of the Reclamation District if the option was exercised?

A. The purchaser would.

Q. Would own all of what bonds?

A. All of the bonds of the district. I personally guaranteed with them that I deliver all the bonds and we were contemplating then dissolving the Birch Securities Company and, therefore, the bonds would come back into Mrs. Birch's hands and to me, 51 per cent to Mrs. Birch and 49 per cent to me.

Q. As I understand it, that option was exercised?

A. Yes. [193]

Q. When? A. July the 1st, 1946.

Q. Who held the bonds during that period the option was outstanding, particularly at the end of the fiscal year 1944?

A. By that time, I believe, the dissolution had practically been completed and Mrs. Birch and I owned the bonds.

Q. Do you refer to the one million five hundred ninety-four thousand dollars worth, or did you and Mrs. Birch, at the end of 1944, fiscal year 1944, acquire more than that amount of bonds?

A. Yes, we acquired more. We purchased some more of the Hopkins bonds at that time.

Q. Now, our stipulation shows, I believe, although it speaks for itself, that even way back in these early years you had an agreement to acquire from the Hopkins sisters all of their three hundred ten thousand dollars worth of bonds, didn't you?

(Testimony of A. Otis Birch.)

A. That was the balance of 786 bonds they originally had and received in 1925.

Q. Did you ever reacquire all of the three hundred ten thousand dollars worth of bonds from the Hopkins sisters?

A. Yes. We completed that transaction in 1944.

Q. Completed it in 1944? [194] A. Yes.

Q. Now, referring to a few of the bonds which were outstanding, was Lula Minter a relative of yours in any respect? A. Yes.

Q. What was the relationship?

A. She was a cousin.

Q. Had she held a land interest in any portion of that? A. What?

Q. I say, did she hold it at the very commencement of the reclamation district? A. No.

Q. Well, how did she first acquire any interest in land or bonds?

A. She didn't acquire any interest in land, but she purchased ten thousand bonds. She had previously loaned me money and I paid the loan by giving her those bonds.

Q. Did she ever receive any of this interest from the county treasurer, if you know, or did she merely use coupons to turn in?

A. That is the way she would get the interest, wouldn't she?

Q. Her coupons were actually turned in?

A. Yes.

Q. Now, referring to this, was the Republic

(Testimony of A. Otis Birch.)

Life Insurance Company—you were an officer of that corporation, too, [195] were you not?

A. Yes.

Q. What was the nature of that corporation's business?

A. It was a life insurance company.

Q. Was money borrowed from the company and then bonds held by it as security?

A. No. It purchased bonds outright.

Q. What year was that?

A. About 1927, the date that it purchased the 86 bonds.

Q. Now, up until the time when you actually reacquired these Hopkins bonds, you at all times had an agreement—I mean you and your wife—had an agreement to repurchase those bonds from the Hopkins sisters. Isn't that right?

A. Yes. They kept the original contract alive by these extensions.

Q. Were a large number of bonds, we will say something in excess of a million dollars worth, face amount, held by certain trustees, pending the payments by you and your wife for those Hopkins bonds? A. Yes.

Q. So, that is where the bulk of your bonds were held, we will say, during several years prior to 1944?

A. Well, they were in trust, and in 1934, when the Securities Company was organized, the bonds still remained in trust. [196]

Q. As I understand your testimony, before 1934,

(Testimony of A. Otis Birch.)

before you had any Securities Company or Birch Ranch & Oil Company, you and Mrs. Birch owned some of the reclamation bonds directly and held them personally. Was that the situation then?

A. That is correct. We held all of the bonds when they were originally issued, except the 786 that were held by the Hopkins for their interest in the ranch property.

Q. The Hopkins girls, their original name was Smith, was it not?           A. Yes.

Q. And they were sisters?           A. Yes.

Q. And they married two brothers?

A. That is correct.

Q. And the brothers' name was Hopkins?

A. That is right.

Q. Then, the Hopkins girls referred to, as such, were your nieces, were they not?           A. Yes.

Q. So, then, the Hopkins gentlemen, their respective husbands, were your nephews by marriage. Is that the situation?           A. Yes.

Q. Just so the Court gets the background of this picture. Then to start off——

Mr. Acret: Just a moment. Is there any insinuation [197] about that? Is it necessary to go into all of these dealings, the harshness, the feelings of the Hopkins and Birch over a period of twenty years? Counsel knows the facts of how hard these people were, and Mr. Hopkins testified in the former case that, as far as he was concerned, the bonds had to be paid and the contract had to be paid to the latter and promptly.

(Testimony of A. Otis Birch.)

Mr. Crouter: He has answered the question.

Mr. Acret: Tax cases shouldn't be tried like a criminal case, by insinuation or innuendo. I don't think it is high class.

The Court: The Court will give such effect to the testimony as it feels it deserves.

Q. (By Mr. Crouter): Mr. Birch, referring to the agreement here, dated January 10, 1925, which apparently was between you and Mrs. Birch, the first parties, and Louise Smith Hopkins, the second party, this being Exhibit No. 15 in the case, if your Honor please, I notice this was marked on the face of it, "Cancelled" and below that the name "Louise Smith Hopkins, March 15, 1944." Please tell the Court what, if anything, was done in addition to this document, with respect to any cancellation.

A. On this date or just prior to it, we paid them \$260,000.00, the balance of the \$310,000.00 that we owed them under the original contract.

The Court: How was that paid? [198]

The Witness: In cash.

Q. (By Mr. Crouter): By "them" do you refer to Louise Smith Hopkins and also Ruth Smith Hopkins, whose names are on Exhibit 14?

A. Yes, sir.

Q. Now, the Hopkins sisters had an interest in the land, to begin with, that they had acquired from their parents, I suppose, is that correct?

A. No, not at all.

Q. They did have an interest in some of the land prior to the organization of any reclamation district, did they not?           A. Yes.



(Testimony of A. Otis Birch.)

Q. And one or some of the agreements you had with the Hopkins sisters provided that you, personally, or Birch Ranch & Oil Company would purchase from the Hopkins sisters all of their land in that district. Isn't that correct?

Mr. Acret: That is objected to. The agreements speak for themselves. They are in evidence. Also, the stipulation as to facts speaks for itself. The witness' conclusion on it is immaterial.

Mr. Crouter: I haven't had a chance to read all of this. Do you mean Exhibits 14 and 15?

The Court: If they are in evidence, it is not necessary to go into it again. I thought counsel was simply using that as a predicate to another question. [199]

Mr. Crouter: I am getting back to another question.

Mr. Acret: I am referring to Exhibits 14 and 15, yes.

Mr. Crouter: I believe he could state that.

Q. (By Mr. Crouter): Was that the fact of the matter, that the agreements, Exhibits 14 and 15, provided that you and Mrs. Birch would acquire all of the interest that any of the Hopkins sisters had in any and all of the lands which was included in the reclamation district?

Mr. Acret: Just a moment. I don't think it is particularly dangerous, but it is always a poor practice, I believe, to take an agreement that is ten, twelve, or fifteen pages, and seek to interpret it.

(Testimony of A. Otis Birch.)

The Court: I will ask counsel, is there any controversy about that fact?

Mr. Crouter: Not so far as I know, but I do wish to establish whether the Hopkins had any other land.

The Court: What is the materiality of this witness saying it is in there again, repeating it orally.

Mr. Crouter: I withdraw the pending question.

Q. (By Mr. Crouter): Please tell the Court whether it is a fact that you had an agreement with the Hopkins sisters to purchase from them any and all bonds of the Reclamation District which might have been held by them, that you would purchase the bonds, as [200] well as the land, from them.

Mr. Acret: That is objected to as not the best evidence. The agreements which are in evidence, I think Exhibits 14 and 15, speak for themselves.

The Court: If the exhibits show, the Court is not going to permit the subject to be explored by oral testimony, if it is already in evidence.

Mr. Crouter: I will cover it now and at noon I will read the document.

Q. (By Mr. Crouter): Were there any bonds or lands, which in any manner related to the reclamation district, which the Hopkins sisters owned, the purchase of which was not covered by any other writing except Exhibits 14 and 15 before you?

A. And the extensions made from time to time after the time would have run, which was 1935, the date that the last purchase would have become due,

(Testimony of A. Otis Birch.)

having agreed to purchase ten per cent of the bonds, beginning 1926.

Q. Were those extensions in writing or just orally?

A. A very exacting written agreement, after consultation with their attorneys, and persuasion of granting of an extension.

Q. Now, I take it, from your testimony, that none of the bonds of reclamation district were actually retired at any time prior to the conclusion of any and all dealings with the Hopkins [201] sisters. Is that correct?

A. Any bonds retired due us?

Q. Retired and paid off and cancelled by the county treasurer?

Mr. Acret: That is objected to as calling for a conclusion. The witness wouldn't know the effect of the refunding issuance of the refunding bonds.

Mr. Crouter: Let's let him answer; find out.

Mr. Acret: That is quite important, your Honor, when the law of California permits repayment of a first issue and expressly provides, by a special act, for a refunding issue of these reclamation bonds. I don't think it is proper for a witness to be asked to form a legal conclusion.

The Court: The witness isn't required to do that. Any transaction that occurred, with which this witness is familiar, he might testify, but the effect of it would not be binding upon the Court.

Mr. Acret: It is our contention, your Honor, that Act 2480a provides for refunding, and that refund-

(Testimony of A. Otis Birch.)

ing issue is a repayment and the law expressly contemplated that be done in that manner.

The Court: Well, the witness can't impeach the law or interpret the law for the Court. The Court will have to do that.

Mr. Crouter: If your Honor please, what I would [202] like to know from this witness, and all I am asking him, and your Honor appreciates that both of us, it seems to me, all of us are working in the dark a little bit, because we do not have complete written records of what was done. Now, the question is whether any of the bonds, the principal of the bonds, was actually paid back to any holders by the Birch Ranch & Oil Company, and that is my question to Mr. Birch right now.

The Court: Does he know that or not?

Mr. Crouter: I believe he should.

The Witness: Yes, I know.

The Court: What is the answer?

The Witness: No, if there had been any redeemed, there wouldn't be a refunding issue for the full two million face value.

Q. (By Mr. Crouter): Please tell the Court whether that was still the situation at the end of the fiscal year 1944, that no principal amount of the bonds had ever been paid back.

A. No.

Q. That is the way it stood?

A. Yes.

Mr. Acret: I move to strike that as immaterial. Under the new refunding issue, none was due. So, it is immaterial. [203]

The Court: He can state what his opinion was.



(Testimony of A. Otis Birch.)

If it is in conflict with the law, the law would show, and not his opinion.

Mr. Acret: I think my objection of record, as I go along, would be helpful to the Court later on.

The Court: Yes.

Q. (By Mr. Crouter): Mr. Birch, I will not attempt to read to you various provisions of the California law, but I would like to ask you whether at any time there was any default in payments of principal as required under any first bond ever declared by any state, county, or reclamation authorities, and any foreclosure on the property ever instituted by any official body?

A. They instituted an action by the Postal Union Company to collect on those 86 bonds, but the settlement was made with them, so that the action was dismissed.

Q. But there was never any default declared by any state authorities, as I understand it. Is that correct?

A. No.

Q. You mean that is correct?

A. That is correct.

Q. During the year 1937, up until about the middle of 1943, did I understand you to say that these calls and assessments that you referred to, as such, by the county treasurer, were still made during that period? [204]

A. No, I believe they were not. There might have been one in 1937, but not subsequent to that.

Q. Well, was there any particular reason why they were not, besides what you have told the Court,



(Testimony of A. Otis Birch.)

I mean, any agreement or anything in writing between the corporation, Birch Ranch & Oil, and the county treasurer?

A. No, there wasn't any agreement or anything that I know of, except on general principles; both the county assessor in Yolo County and other counties tried to cooperate with the landowners, to enable them to live, and at the same time the county collect some taxes. I know the taxes, as far as the county assessor is concerned and the county tax collector, they made the five-year payment plan and the ten-year payment plan.

The Court: Ad valorem taxes, you are speaking of, five-year payment plan?

The Witness: Yes.

The Court: They couldn't pay their ad valorem taxes?

The Witness: Couldn't pay the land taxes in the extended time, but would pay—would pay interest on the current payments.

The Court: Is that taxes on levy districts or is that the general state taxes?

The Witness: That was the general state taxes, but I am merely reciting that as a comparison. It might have been [205] the same thought in mind with the county treasurer, that he wasn't going to assess land or make calls when he knew the property owners couldn't pay.

Q. (By Mr. Crouter): I suppose then, in 1943, there was a large amount of unpaid and overdue money, whether you call it taxes or interest, due on

(Testimony of A. Otis Birch.)

bonds that were payable, which sums were payable to the county treasurer, according to the records?

A. Yes.

Q. That was the real situation? A. Yes.

Q. But the county was not doing anything about that, as far as foreclosing on the land, was it?

A. No, they didn't foreclose. If they hadn't made any calls, there wasn't anything in default, no action taken.

Q. You had to have a call by the county treasurer before there was any default?

A. And the sale of the land, in the absence of payment of the call.

The Court: First a call, then a default, then a sale?

The Witness: Yes, sir.

Mr. Acret: Your Honor means in event of failure to respond to the call. Is that what Your Honor means?

The Court: Yes. [206]

Q. (By Mr. Crouter): Are you able to tell the Court what periods the amount of interest, as reflected by Exhibits 9, 10, 11 and 12, referred to, when these checks were issued here and payments were made, as shown by these exhibits. What I mean is, was that current interest or interest or taxes, or did it relate to 1940, 1942, or what period did that relate to, if you know?

A. I believe the first call made after that deferred call took place was to cover coupons that had matured. After those coupons, all past due

(Testimony of A. Otis Birch.)

coupons, had been redeemed, then regular calls were made for the current accumulation and maturity of the interest on the bonds.

Mr. Acret: I didn't object to this. I didn't examine this witness, your Honor, on that matter, because I didn't know he had any familiarity with it. Mr. Landrum was the one put on with respect to those payments, since he is the bookkeeper.

Mr. Crouter: I believe it is a part of the general picture.

Mr. Acret: I think the witness has answered it, but I believe he is out of his field, the purpose for which he was put on the stand.

Q. (By Mr. Crouter): Referring to Exhibit No. 12, Mr. Birch, and the reference here in the attached document of August 14, 1944, [207] reading as follows: "Payment to cover the unpaid portion of Call No. 21, dated December 1, 1935, together with penalty thereon, R. E. C. Dist. No. 2035, \$37,325.28." Now, that indicates to you, does it not, Mr. Birch, that the call then was for amounts which, according to the records, apparently were due as of certain prior years?

Mr. Acret: That is objected to as argumentative; calls for a conclusion of the witness. The document speaks for itself.

The Court: I think the document would be the best evidence.

Q. (By Mr. Crouter): Referring to Exhibits 9, 10, 11 and 12, Mr. Birch, please tell the Court whether it made any difference to the actual ranch

(Testimony of A. Otis Birch.)

operations of Birch Ranch & Oil Company, during the fiscal year 1944, whether those payments were made or not. I mean, could you still operate the ranch, and so forth?

Mr. Acret: That is objected to as argumentative.

The Court: What is the materiality of that question?

Mr. Crouter: I want to know whether this was a necessary condition to operation in any manner, either by any court proceedings or official demand of a county tax collector, anything of sort; whether there is any other reason for making the payments at this particular time.

Mr. Acret: Section 23 C2E, I think it is, provides for deductions for interest paid to meet local benefits on assessment bonds, and I think the law speaks for itself, and the call shows what it is for. It seems to me those four documents cover the whole case, combined with the law of the reclamation act.

Mr. Crouter: I will withdraw the pending question.

The Court: It is withdrawn.

Q. (By Mr. Crouter): Mr. Birch, you testified before Judge Turner in the prior proceeding, which has been referred to here, in April, 1943, did you not? A. Yes.

Q. Do you recall at that time there was a question involved as to whether the ranch was on the accrual or cash basis of accounting?

A. That is correct.

Q. Please tell the Court whether after that pro-



(Testimony of A. Otis Birch.)

ceeding had been heard by Judge Turner, and the case was decided, you then held certain conferences with your representatives and decided that there was a question of the ranch being on the cash basis of accounting, you would then make actual payments to the county treasurer, and by "you" I mean the Birch Ranch & Oil Company. Isn't that one of the reasons those payments were actually made in 1943 and 1944?

A. No. The reason we paid them was because we were able [209] to raise the funds to pay them. Prior to that time, during that depression of about from 1931 to 1933, we didn't even operate the ranch and couldn't pay the taxes, the county taxes, I mean to say, and we were unable to refinance our obligations to raise any funds to apply on taxes, either the county, to the county tax collector, on the land or the assessment on the reclamation district.

Q. Very well. Please tell the Court what the facts were, whether it is not true that you did on certain occasions make arrangements to borrow money from one of the California banks, perhaps of Sacramento, and get a certified check or several checks that would be payable to the county treasurer, and actually paid to the county treasurer, and then at about the same time you would secure another check or several checks from the county treasurer, representing payments of this tax exempt interest, and that check from the county treasurer went back to the bank, paid for money which you had borrowed.



(Testimony of A. Otis Birch.)

Mr. Acret: That is objected to as immaterial.

The Court: I will overrule the objection. If he knows, he may answer. Did that happen, as has been detailed to you by the question?

The Witness: I don't recall borrowing money of a bank temporarily to pay an assessment.

Q. (By Mr. Crouter): Would you say that never happened? [210]

A. Yes, I would say that the loans that we got from the bank were for the operation of the ranch or for some other purpose, and not for the purpose of paying an assessment.

Q. (By Mr. Crouter): What was the situation as to whether all amounts due on any bonds, according to their terms, were all paid up prior to the transactions you have mentioned with Mr. Rasmussen and the Woodland Farms, Inc. Were any and all payments made paid up prior to the transaction with Mr. Rasmussen?

A. All of the coupons, I believe, were paid, but the bonds hadn't been paid for in full to the Hopkins.

Q. I mean, with respect to amounts due the county treasurer, under the interest on bonds or taxes on bonds, as you have referred to, were all of those amounts cleared up of record at the time the option was exercised and the deal was cleared out with Mr. Rasmussen and Woodland Farms?

A. I can't recall the exact date when all the arrears of past due coupons were taken up. I know

(Testimony of A. Otis Birch.)

they were completed in 1944, but whether it was completed in 1943, I wouldn't be able to say.

Q. Do you recall, in June, 1946, there was one payment or there were several payments aggregating \$474,272.53 paid to the county treasurer, and at about the same time there was one check or there were several checks aggregating \$480,000.00, [211] which were paid by the county treasurer back to the holders of bond coupons?

A. That was closing up everything that was due and past due, going out of this sale under the option.

Q. Did the Birch Ranch & Oil Company——

Mr. Acret: Just a moment. If that is subsequent to September 30, 1944, it is immaterial. I move it be stricken, because the date is not shown.

Mr. Crouter: I believe it is relevant and material. We are concerned with this whole picture.

The Court: I will overrule the objection. It is already in evidence.

Mr. Acret: I am making these objections, your Honor, so that issues won't be injected that will unduly extend the proceedings.

The Court: The Court doesn't want to extend beyond what is absolutely necessary, because the record is large enough now. I trust counsel will help to hold it down.

Mr. Crouter: Yes, I will endeavor to do my best, if the Court please.

Q. (By Mr. Crouter): Mr. Birch, do you have with you any official documents from the Commissioner of Internal Revenue relating to any accept-

(Testimony of A. Otis Birch.)

ance of a prior return or any adjustment of a prior return with respect to this question of interest deductions? [212]

A. I haven't anything personally.

Mr. Crouter: Perhaps, your Honor, counsel can show me something on that.

Mr. Acret: I think we put in a letter of about 1931.

Mr. Crouter: During the noon recess, I will be glad to see what we have.

The Court: Yes, during the noon recess, check on those things, if you will.

Q. (By Mr. Crouter): Referring to your testimony that you had no intention at any time to avoid taxes, please tell the Court whether it is a fact that in connection with your original organization of the Reclamation District, you did understand and have the intention of receiving from the county treasurer these various amounts of so-called tax exempt interest. A. My original understanding——

Q. Yes, whether you were informed of that and that was naturally a part of the original plan, as you started out, and a part of the plan as it actually operated?

A. I know that is provided for in the statutes of the state, that if bonds are issued, they will be tax exempt, but that didn't enter into this thing of organizing a district for the purpose of receiving bonds. It was represented to me by the Reclamation Board that if we performed this work——

Mr. Acret: I ask the witness be instructed to

(Testimony of A. Otis Birch.)

answer [213] the question, and not inject other issues.

The Court: Don't get off into some other question.

Mr. Crouter: I just wanted an answer to the question. I asked, as best you can, but give us whatever explanation you want to make.

The Court: He was explaining he understood the law, but that didn't induce him to take this action, as I understand. [214]

Q. (By Mr. Crouter): Please tell the Court what, if any, reason there was for not paying off any part of the principal amount as the first bond became due, as they were originally issued.

A. We didn't have the funds and it was a common practice for all districts to refund bonds from time to time.

Q. That is, just reissue other bonds?

A. Yes. That is provided for.

Q. Well, in 1935, your first bond became due, didn't it?

A. Yes.

Q. That is, the principal as well as interest?

A. Yes, and we were under quite a depression then yet. We hadn't recovered at all, and could not meet the payments and, therefore, the only alternative was to have a new issue.

Q. Do you have any balance sheets or financial accounts of your corporation for these various years, so we could see exactly what the financial condition of Birch Ranch & Oil Company was during each of these years?

A. No, I am not the bookkeeper. I couldn't read them if I had them.



(Testimony of A. Otis Birch.)

Q. You have not brought anything of that sort to the Court? A. No.

Mr. Acret: When Mr. Landrum was here, I believe he stated he had the books with him. He was the bookkeeper. [215]

Mr. Crouter: I don't recall any such. I believe that record speaks for itself, anyway.

Mr. Acret: Yes, and I am having it speak further, and I believe I stated the books were available for counsel's inspection. Further than that, if he desires Mr. Landrum to be back with them, he only has to so state.

Q. (By Mr. Crouter): Mr. Birch, have you ever added up the total amounts paid to the County Treasury by Birch Ranch & Oil Company, or by anyone on behalf of that company, as amounts of interest or taxes on these calls or assessments?

Mr. Acret: That is objected to as argumentative, your Honor. It is obvious that the accruing interest is the fixed amount, six per cent a year on two million dollars, whatever number of years it is, and besides that, it is immaterial, irrelevant, and tends to prove nothing. He has to pay whatever the law requires.

The Court: The Court didn't get the question. Will you read the question, Miss Reporter?

(The question was read.)

The Witness: No.

Q. (By Mr. Crouter): But, as I understand, your testimony is that any and all payments which



(Testimony of A. Otis Birch.)

were made were merely on the call for interest or taxes, and that none of that related to any payment [216] of principal amount of bonds.

A. No, nor didn't include any expenses, other expenses of the district.

Q. I believe our stipulated facts show that those other expenses of operating, and so forth, were paid and handled by the ranch itself?

A. Yes, but if we had to set up a set of books to operate the district and employ an office force and draw salaries on the administration of the affairs of the company, we would have created an additional cost, and that would result in additional bonds being issued to meet the costs.

Q. Now, referring to your testimony about your intentions when this reclamation district was first organized, I suppose you had some legal advice from this legal firm of Armfield & Eddy with respect to the tax phase of that matter, did you not, Mr. Birch?

Mr. Acret: That is objected to, counsel, as assuming something not in evidence.

The Court: Ask him if he had; not assuming.

Q. (By Mr. Crouter): That is my question: Did you?

A. No, I didn't have the details taken care of. We had this Mr. Conaway and Mr. Hopkins, who were active members in the ranch. Just what they conferred with the attorneys, I don't know. [217]

Q. Did you, yourself, receive any advice from any attorney or accountant with respect to the tax

(Testimony of A. Otis Birch.)

phase of that matter, prior to the organization of any reclamation district?

A. No, and, furthermore, we didn't have any thought in mind of ever getting out a bond issue.

Q. How did you learn of the tax exempt phase of that matter, if you can recall, back when it first came to your attention? That was a matter of State law, of course, but when did that first come to your attention?

A. After we received the bonds in 1925.

Q. You did not know of it, then, before that time? A. No.

Q. Referring to some of your testimony on direct examination, by Mr. Acret, with respect to the time that you waited either for money for the work that you did, or for something else from the district, it is true, isn't it, that you never did receive any money from the Reclamation District for the work either you did individually or Birch Ranch & Oil Company had done on the land?

Mr. Acret: Just a moment. That is objected to as argumentative, immaterial, your Honor. The statute provides that the County may pay in the warrant. That is the same as money, and it is immaterial.

The Court: He can state what he did, whether he received cash or warrants. [218]

Q. (By Mr. Crouter): So that you will understand, I am referring to a question which, as I recall, was: "How long did you wait for your money

(Testimony of A. Otis Birch.)

for the work that you and Mr. Conaway did in improving the district?"

I want you to tell the Court whether you ever received any actual money from the County or Reclamation District for that work.

A. I never received any money. I understood at the time the question was put, "Did we have any settlement," and the settlement was the issuance of this warrant and the exchange of the warrant for the bonds that were then ready to be floated.

Mr. Crouter: I have quite a bit more to go, if the Court please.

The Court: We had better recess until 2:00 o'clock, and counsel, in the meantime, can check on the records on some of these matters.

We will take a recess until 2:00 o'clock.

(Whereupon, at 12:15 p.m., a recess was taken until 2:00 o'clock p.m. of the same day.)

#### Afternoon Session

The Court: Proceed.

Mr. Crouter: If your Honor please, with Mr. Acret's kind permission, Respondent at this time would like to call a witness from the Collector's Office with respect to a very limited matter.

The Court: Very well.

Mr. Crouter: Miss Madeleine Webb, will you please be sworn and take the stand?

## MADELEINE WEBB

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

## Direct Examination

By Mr. Crouter:

Q. I believe your name is Madeleine Webb?

A. Yes.

Q. Please tell the Court your present occupation.

A. I am a clerk in the Collector of Internal Revenue Office, in the Income Accounts Correspondence Section.

Q. Of what office?

A. Of the Collector of Internal Revenue.

Q. And that is for the Sixth Collection District of California?

A. The Sixth Collection District of California.

Q. Located right here at Los Angeles?

A. Yes, sir.

Q. About how long have you been connected with the Office in any capacity?

A. A little over four years.

Q. Please tell the Court what, if any, general knowledge you have of the records of the Collector's Office, particularly with respect to the making and keeping of records concerning payments on any asserted income and declared value excess profits taxes.

Mr. Acret: There is no question as to the lady's qualifications or the competency of this testimony.

(Testimony of Madeleine Webb.)

Mr. Crouter: Thank you.

Q. (By Mr. Crouter): I show you Exhibit 4 in this case on hearing before the Tax Court, and call your attention to the fact that this is headed "Taxpayer's Receipt" and it is for an amount of \$12,398.85.

Have you, at my request, examined the original records of the Collector's Office to ascertain exactly what those records show with respect to the question whether or not that total sum has been assessed against a taxpayer known as Birch Ranch & Oil Company?

Mr. Acet: I think that is irrelevant and immaterial, self-serving. [221]

The Court: Overruled.

Q. (By Mr. Crouter): The question is, first, whether you examined. A. Yes.

Q. Did you learn anything from the records relating to that identical amount?

A. Yes, I did.

Q. Did I understand your examination was based on the original permanent records of the Collector's Office? A. Yes, sir.

Q. Will you please tell the Court exactly what those records show with respect to the payment of any such total sum as I mentioned?

Mr. Acet: I am not making further objection.

The Court: I understand your exceptions to this testimony.

The Witness: The Collector's record does disclose that a remittance of \$12,398.85 was received in



(Testimony of Madeleine Webb.)

the Office on July 7, 1947, to apply on an additional tax for the fiscal year ended September 30, 1941, for the Birch Ranch & Oil Company.

Q. (By Mr. Crouter): Does it indicate what kind of taxes?

A. It indicates additional income and excess profit tax for the fiscal year ended July 30, 1941. This remittance was [222] received, and since there was no assessment on the Collector's records, it was deposited in the unidentified accounts, which is termed "9-D Suspense Accounts."

Q. About what date was that done?

A. That was upon receipt of same deposited in the 9-D Account.

Q. Very well. Please proceed.

A. It remained there from the time—may I explain it this way, that if this remittance—any remittance received after July 1, 1947, up to and including June 30, 1948, which is the fiscal year of the Collector's Office, a remittance remains in the unidentified accounts until such time assessment is set up on the lists to which it could be applied, and then January of 1949, it is taken from the cashier's section, that 9-D, and deposited with the Income Tax Account Section 50, where it remains until an assessment comes through to which it could be applied.

Q. Is that Section 50 Account known by any other popular designation?

A. Unidentified accounts.

Q. Did the Collector have anything which was classified as a suspense account?

(Testimony of Madeleine Webb.)

A. Yes, also called a Suspense Account, Mr. Crouter.

Q. The Section 50 Account?

A. Section 50. [223]

Q. What is the present status of the records of the Collector's Office with respect to that identical amount of \$12,398.85?

A. At the present time it is in Section 50, the suspense account, under Account No. January 501228 on the '49 list, where it will remain until an assessment is recorded on the Collector's list, and at which time it will be transferred to the assessment.

Mr. Crouter: You may examine.

Mr. Acret: No questions. You understand, your Honor, our exception ran to all this testimony?

The Court: I understand the Petitioner reserves the exception to all the material, as being immaterial and irrelevant.

(Witness excused.)

Whereupon,

A. OTIS BIRCH

called as a witness for and on behalf of the Petitioner, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination

(Continued)

By Mr. Crouter:

Q. I would like to show you Exhibit No. 7 in evidence, and, if your Honor please, this is the group

(Testimony of A. Otis Birch.)

of documents which relate to an election. It is headed, "In the Matter of the [224] Legality and Validity of Refunding Bonds of Reclamation District 2035 Authorized at an Election Held in Said District on December 4, 1934."

Now, Mr. Birch, I suppose you were familiar, perhaps not with the details, but the fact that proceedings such as shown by Exhibit No. 7 here were being instituted in court at about that time.

A. I heard of it, but I didn't attend the court session.

Q. You did not attend the court session?

A. No.

Q. One of the original or first documents there seems to be what is headed "Complaint." That is this Docket 220, filed in the County Court of Yolo County, and the caption of the proceeding seems to be: "Reclamation District No. 2035, Plaintiff, versus The Lands in Said Reclamation District No. 2035, and All Persons Owning the Same or Interested Therein, Defendants." Now, the owners of the bonds of the Reclamation District at that time,—you see, that is filed April 26, 1935—I believe you have told us about all the owners of the bonds outstanding at that time, have you not?

A. What was the question?

Q. You have told us about who owned the bonds?

A. Yes.

Q. I think the record establishes that?

A. Yes. [225]

Q. Now, referring to the parties designated de-

(Testimony of A. Otis Birch.)

endants, "The Lands in Said District and All Persons Owning the Same or Interested Therein," can you tell us, in a rather specific way, who held the deeds on all the lands that were involved there, and exactly who these defendants were, the corporations or persons involved, just thinking back at that time?

Mr. Acret: I think that is immaterial, your Honor, as to this particular proceeding.

The Court: I don't see the materiality.

Mr. Acret: There is a stipulation as to who owns the lands.

The Court: What is the pertinency of that testimony?

Mr. Crouter: Well, the purpose is to show the identity of interest, if any, between the parties to the proceedings, if the Court please. I have in mind the question which will be argued on brief, as to whether the proceedings reflected in the State Court, the first page, of course, showing a default in that proceeding, whether that was a regular litigated result and, if so, who the parties were.

The Court: The Court is not going to permit a collateral attack on a judgment. I am not going into that matter. I don't think it is proper in this court.

Mr. Crouter: May the Respondent have an exception?

The Court: Yes, indeed.

Mr. Crouter: Would your Honor permit one question [226] as to whether the Birch Ranch &

(Testimony of A. Otis Birch.)

Oil Company or Mr. Birch, individually, was a defendant in this proceeding?

The Court: Yes, that is all right.

Q. (By Mr. Crouter): Please tell the Court, Mr. Birch, first, whether the Petitioner, the Birch Ranch & Oil Company, was a defendant in this proceeding. In other words, did it own lands within that district, so that under the classification it was a defendant?

A. Yes. As I understand the Court proceeding, it would name the land in the Reclamation District and the individuals owning the lands, and the purpose of the action was to validate——

The Court: The question is whether or not the Birch Company owned any land at that time.

The Witness: All but one parcel.

The Court: They didn't own all the land?

Mr. Acret: I would be willing to stipulate that at that time it owned all but one parcel.

The Court: All right. Save time. So stipulated?

Mr. Crouter: Yes, I am glad to accept the stipulation.

Mr. Acret: That doesn't, however, waive my objection that it is immaterial, because it is my theory that when a street assessment is once validly put in front of my lot, if I subsequently buy some of the street bonds in that assessment, that doesn't invalidate the assessment against my lot. [227]

The Court: Yes, I understand.

Q. (By Mr. Crouter): Now, Mr. Birch, our stipulated facts indicate that there were about 21,000 acres in the assessment, or the Reclamation



(Testimony of A. Otis Birch.)

District. That was back at an earlier stage, I believe, and what I would like to have you tell the Court is the amount of land that was included in this court proceeding here not owned by the Birch Ranch & Oil Company. How extensive was it, how many acres?       A. 320 acres.

Q. Do you remember who owned that 320 acres?

A. A man whose name is Mr. Swanson.

Q. Prior to the organization of the Birch Ranch & Oil Company, who owned the land that was included in that district; who held the title to it, if you remember?

A. Originally, there were several, but as time went on, Mrs. Birch and I acquired all of the property.

Mr. Crouter: I may say, if the Court please, that since the original stipulation of facts was filed, we have, by agreement, had it numbered, so that each paragraph bears a number and the paragraphs are numbered from 1 through 25.

The Court: That is so it can be conveniently referred to.

Mr. Acret: I numbered my copies similarly, so we will be able to refer to them. [228]

The Court: Has that been done with the one placed in the custody of the Clerk?

Mr. Crouter: Yes, it has. We took that liberty, hoping it would be agreeable to your Honor.

The Court: Yes.

Q. (By Mr. Crouter): Mr. Birch, please tell the Court, in a general way, whether most of the

(Testimony of A. Otis Birch.)

land of the Birch Ranch & Oil Company was being cultivated or the approximate amount that was being cultivated, put to cultivation and growing of crops, and what amount was pasture, and so forth.

A. About half and half divided. The land in the by-pass amounted to about 8,500 acres, and in what was called the Settling Basin, that the State created, was 4,000 acres, and the ranch together, comprising twenty-one or twenty-two thousand acres. That would be almost a fifty-fifty division.

I might add, though, there were some 1,300 acres outside of the district that belonged to the ranch.

Q. Did the County Treasurer ever make any call or demand for a payment by the Birch Ranch & Oil Company of any principal amount on the bonds there?

Mr. Acret: That is objected to as immaterial. The evidence showed no principal amount came due until 1935.

The Court: I will overrule the objection.

The Witness: No, there was no call ever made for [229] retiring any of the bonds.

Q. (By Mr. Crouter): Was Mr. Swanson related to you in any manner?

A. No, not at all.

Q. Mr. Birch, do you recall whether at any time in 1943 there was any payment made to the County Treasurer in the name and by check of the Birch Securities Company?

A. No. I recall that there wouldn't be any.

Q. There would not be any?

(Testimony of A. Otis Birch.)

A. There would not be any, no.

Q. Do you recall that there was ever any mix-up between the Birch Securities Company and the Birch Ranch & Oil Company?

A. Not to my knowledge.

Mr. Crouter: I believe that is all, if the Court please.

The Court: Any further questions by Petitioner?

Mr. Acret: If your Honor please, one or two questions.

Redirect Examination

By Mr. Acret:

Q. Mr. Birch, you testified here about the Great Republic's purchase of the bonds. Do you know how they came to purchase the bonds, the Great Republic Life Insurance Company?

A. Just an investment. [230]

Q. That is, the bonds were investments for trust purposes?

A. Yes, or for deposit in the reserve of the company.

Q. You didn't have anything to do with their buying the bonds, or did you have anything to do with that?

A. I believe Mr. Conaway really delivered the bonds to the insurance company. I was on the board of directors and the executive committee of the insurance company. I knew of the purchase.

Q. What did you say, you were on the board?

(Testimony of A. Otis Birch.)

A. Yes, I was the president of the insurance company and was on the board of directors.

Q. You were not connected with the Republic Life? A. Yes.

Q. Do you know what they paid for the bonds?

A. Yes.

Q. What was it?

A. \$80,000.00 for the 86,000 par value.

Q. Now, you mentioned about agreeing to giving or having the Securities Company give Mr. Rasmussen an option to buy the bonds. Was the Securities Company in a position to get the Minter Bonds at that time?

Mr. Crouter: If your Honor please, I object to that, in that that should be shown by records of the Securities Corporation. [231]

The Court: What was the question?

Mr. Acet: Well, it is a small matter. I don't want him left in the position—I thought there was some insinuation he couldn't deliver the bonds.

Q. (By Mr. Acet): You had the Hopkins contract and the means of getting all the Hopkins bonds? A. Yes.

Q. Did you eventually get the Minter bonds?

A. We did, yes.

Mr. Acet: I think that is all.

The Court: Stand aside.

(Witness excused.)

The Court: Call your next witness.

Mr. Acet: We rest, your Honor.

The Court: Does Respondent have any further testimony?

Mr. Crouter: I just want to check my exhibits. I believe they are all in, if the Court please.

Mr. Acret: I possibly can stipulate concerning the others.

Mr. Crouter: Respondent rests, also, if the Court please.

Mr. Acret: I wonder if it would be helpful at this time to make a short summary and leave some thoughts with your [232] Honor.

The Court: It would be agreeable with the Court.

Mr. Acret: It may be helpful just to clarify some matters.

Now, your Honor, I have this trial memorandum we prepared——

The Court: Before you begin, let me say this, that, as I understand it, this case, to get the Court's idea, has been tried heretofore in some phases by Judge Turner. It was also tried by Judge Kern of the Tax Court, and when I came here, as I understood, Judge Kern had set the case back for hearing upon one issue, and one issue only, but as I understand it, since Judge Kern's hearing matters have been changed somewhat; the payment has been made, and another taxable year is also involved, which was not involved when he heard the case. Is that correct?

Mr. Acret: No, there is no change in that respect at all.

The Court: What was the issue that Judge Kern heard?



Mr. Acret: Let me review that, and that will make it straight to your Honor.

The Court: The reason I want to get this definitely, I am under the impression that perhaps this record will be one for Judge Kern's decision, rather than mine.

Mr. Acret: I don't think so, your Honor. The only question here that is involved is the Petitioner's right, when [233] you come right down to the analysis of this, to deduct for the year 1944 such moneys as it paid to the County Treasurer to cover interest on these bonds for that year.

If it can deduct it, then it has clearly—that is, the loss of some hundred and eighty-six thousand dollars, which is many times over enough to carry back to wipe out this deficiency for 1942.

The Court: Wasn't that issue also before Judge Kern?

Mr. Acret: No, sir.

The Court: What was the issue before Judge Kern?

Mr. Acret: The matter before Judge Kern was this, that between the time when we filed this petition in the hearing before Judge Kern, the Internal Revenue agent in charge made this first reaudit of the Petitioner's books, and that reaudit, on account of these four payments to the County Treasurer, which are now in evidence, totaling \$221,000.00, and as they stated in the reaudit and the field agent's report, and on account of Judge Turner's decision,—that is the findings of fact; not his decision, his findings of fact in that first case—they allowed us the

total deduction of \$221,000.00, the amount paid as taxes and they upped the loss that we showed in our 1944 return from 84,000 to 186,000 dollars.

The Court: That was after Judge Kern's hearing?

Mr. Acret: That was done just before.

The Court: You are speaking now of what came before [234] Judge Kern?

Mr. Acret: That is right; and when I got in court here, I put that in evidence, that report, and the findings of fact of Judge Turner, to identify what they were. I stated to Judge Kern that we felt then that if we were on a cash basis, we didn't have any case for 1941 and 1943, as alleged in this petition, because we hadn't made any payments during those years, if we were on a cash basis, but that we did make payments in 1944, and that the Commissioner had filed this audit and field agent's report, stating that we suffered a loss for \$186,000.00.

We asked a continuance of the case and asked the Court to take under consideration our right to deduct that loss, as determined by the Commissioner, of \$186,000.00, and he took the matter under advisement and found we were entitled to do it, if we suffered the loss.

The Court: Did Judge Kern render a decision in the matter, findings of fact, or make any conclusion?

Mr. Acret: None whatever. It is just a legal question that we were entitled to a hearing as to whether or not we, in fact, suffered that loss of

\$186,000.00, and your Honor is hearing the matter on the merits, and for the first time on the merits. So, clearly, it is a matter for your Honor's decision.

Judge Kern handled it very capably and adequately in the respects which I stated. [235]

Now, then, that being the case, when that matter was taken under consideration by Judge Kern, and at the hearing before him, I admitted that adopting the field agent's report and the agent-in-charge report, what I will call the first report, that, as to 1941, we could have no case, because we made no payment and we made no payment even in 1943.

Therefore, we didn't suffer a loss in 1943, and had nothing to carry back to 1941. So, I believe I stated in court that we were intending to pay that assessment.

Now, what the Internal Revenue agent did has nothing to do with us. We have a 90-day letter here making a deficiency assessment against us for 1941, and we have a right to pay it at any time and we did, and we did it to relieve that court of the burden of hearing what you might say is our first cause of action, so to speak, with reference to 1941, and the only one here now is the deficiency that is in this report that we brought the petition on with reference to 1943.

If these moneys that we paid to the County Treasurer are not deductible as taxes, then we didn't suffer any loss and we haven't anything to carry back.

So, the whole question before your Honor is the deductibility of this money paid to the County

Treasurer, and that is clear, and I am now ready to start in. Was there any other questions your Honor would like to ask?

The Court: I would like to hear Respondent's counsel with relation to my reference of the case and Judge Kern.

Mr. Crouter: If your Honor please, with respect to the question propounded by your Honor, I would say this, and I refer back to the original petition, if the Court please, which was filed in the case on hearing before your Honor, Docket 8720.

This is the printed petition and your Honor may observe, or the Court will, when it gets into the making of findings in this proceeding and drawing its conclusions, that as is shown at pages 18 and 19 of the original petition, there was a reference to a loss for 1944, and the allegation in sub-paragraph (i) is in part as follows:

"During Petitioner's fiscal year ending September 30, 1944, Petitioner suffered a loss in the sum of \$73,556.88," and so forth.

The Court: That is not the amount of the loss he now claims.

Mr. Crouter: No. I was going to say, if the Court please, that certain specific matters were referred to in the petition here, as to farm losses, and so forth; and then there is a further statement still referring to the year 1944, that, "In its income tax return for said year, Petitioner listed and deducted all of the aforesaid items of loss in the total sum of \$121,084.38," and so forth. [237]

Now, this question of the loss or the claimed de-



ductions on account of Reclamation District payments was not fully or clearly set forth in the petition, and I believe, with all due respect for counsel for Petitioner, and particularly for Judge Kern, it was because there was a real question as to whether the net loss carry-back issue was properly and sufficiently asserted in the petition to give rise to jurisdiction of the Tax Court, in the first place, over the year 1944; so that I am afraid that caused us all a little confusion and a little extra work, but Judge Kern did analyze that and finally came to the clause as shown by his memorandum opinion.

He apparently came to an opinion they were entitled to a hearing on the merits.

The Court: This is the first hearing on the merits with reference to 1943 tax?

Mr. Crouter: That is correct, as to 1942 or 1944. You see, the prior hearing before Judge Turner just related to fiscal years 1937 and 1939, and they particularly involved the accounting question; but I should also say that the question of deductibility on the merits was inherent in that first proceeding, but inasmuch as the decision and the conclusion was based upon the accounting phase of the case, it was unnecessary to pass upon this question of deductibility of these payments, which is now squarely before us, I believe.

That is all I have to say as to the procedural phase of it. [238]

Mr. Acret: I can supplement that just a little more, your Honor. When this petition was drawn, we were going on the theory that we were on an



accrual basis, and on that basis,—and we were alleging certain losses, but when the matter came up before Judge Kern, I confessed our liability on the 1941 deficiency assessment, and took that out of the case, but confessing the liability, and it is on that ground we paid it.

Now, these losses that are alleged in here, the reason I haven't said anything about them, your Honor, is because when we are on a cash basis, they are not of sufficient amount to do us any good. The only thing, if we are not entitled to the deduction of \$221,000.00, we are not entitled to anything. It is just to simplify it. I don't bother with these. They are no benefit to us, and on the cash basis, that is what is the benefit.

Now, then, the whole picture is shown, and correctly shown, by this first report, which is in evidence here.

The Court: Judge Turner's?

Mr. Acret: No, Judge Turner—you see, the only effect and the reason that Judge Turner's findings of fact are *res judicata* is that Judge Turner heard all that same evidence that your Honor has heard, and considerably more.

That case, I think, took probably three or four days, and he made quite voluminous findings of fact on the details of the organization of the Reclamation District, and 1,300 acres of [239] Mr. Birch and associates' lands were excluded by the County Board of Supervisors, though they asked they be taken in the district. They were not taken and some land owners adjacent, that petitioned—about half

of them that petitioned to come in, the County Board of Supervisors didn't allow to come in.

So, in the end, in addition to Mr. Birch and his associates with their lands, there were about eight other separate landowners that were taken in the district.

Judge Turner found as to those details. Then he found as to the manner in which Mr. Birch and Mr. Conway contracted with the district to do the improvements, what improvements they made and the value, and that they got the warrants, and went all through the details of it. Then he found and stated that Mr. and Mrs. Birch, between 1925 and 1934, paid, while they owned the lands in the district, except one parcel, they paid all of the assessments to the County Treasurer.

Judge Turner makes the one error that he called it "interest," and reference to the Reclamation Act shows it isn't; it is taxes. I cite in my brief the case of Little, which concerns an individual whose Reclamation District was somewhat similar, and this court determined that was a payment of taxes and not of interests, by virtue of the provisions of those Reclamation Acts.

The Court: How extensive was the hearing before Judge Kern? [240]

Mr. Acret: I imagine part of a morning. I think after we got started, when he called the calendar, I think we were the first one; maybe from 11:00 o'clock to 12:00, or something like that, of the first morning.

Judge Turner made the findings of fact that Mr.

and Mrs. Birch, in order to operate the ranch, needed a hundred to two hundred thousand a year for operating expenses, and Mr. Birch was getting along in years. Though he appears to be a man so much younger, he is a man that is getting along in years. I think he was even 70 then, or 68, and the bank wanted him to put his property in corporate form.

Judge Turner found he did that for that purpose, in order to get back credit, and there couldn't be any more legitimate purpose of any corporation than that.

Judge Turner stated that he kept out some \$600,000.00 of his property to meet his individual debts. So there is no question about alter ego here, and it is our position it wouldn't make any difference if there were.

Judge Turner also found Mr. and Mrs. Birch deducted the amount they paid from the County Treasurer from 1925 to 1934, I think it was; and said these deductions were questioned, because Mr. and Mrs. Birch received the money back from the County Treasurer as exempt interest, and in this instance the proceeding was approved. So, that is in these findings.

Now, wherein we claim that Judge Turner's findings are [241] *res judicata* with respect to this case is that they are an adjudication of the principal facts in this case, on which counsel relies that the bond issue, you might say, is a fiction. That is all. They are an adjudication of the authenticity of the organization of the Reclamation District and of the

bond issue, in addition to the adjudication that is made by the Superior Court of Yolo County.

Now, of course, as your Honor knows, those adjudications are a matter of form, but they are a matter of form that results in a valid judgment and validates a bond issue so the bonds can be safely sold for investment trust purposes, and that is the purpose of them. They are valuable, valid adjudications, and something to rely on. We have three of them here.

By the way, I would like to state that this trial memorandum of points and authorities, in view of the stipulation we have here, it is laid out in points. While it doesn't exactly meet the rules of the Court, I think in this particular instance your Honor will find it more usable than a regular brief, and I would like to submit it as our brief. I think it is laid out to be of the greatest convenience to the Court.

Our first point, "This Court has heretofore held in this proceeding that it has jurisdiction to determine herein the amount of loss, if any, which this petitioner suffered in 1944 with the view to permitting Petitioner to carry back such loss to offset the deficiency assessment for 1942 involved herein."

So, that is the first point, and answers your Honor's question right there. This hearing is to hear on the merits, if any; whether or not we suffered the loss.

Point II is that the findings of fact of Judge Turner in the former case are *res judicata* of the questions, principal facts in this case.



The third point is that the Commissioner ought to be estopped by making a report and stating that if we don't protest it, it will become final, and wherein it becomes final, we come into this court and change our whole position.

They say we are on a cash basis. Here is what they say in this report: "For the history of the taxpayer, see prior agent's report in new U. S. Tax Court Findings of Fact and Opinion in No. 109,-993." That is Judge Turner's findings of fact.

The additional net loss—now, this where they took our net loss shown on our income tax return for \$84,000.00, which your Honor has before him, and by virtue of these same amounts that are shown on the second page, and it says, "Amount allowed in this report consists of four payments in 1944 by certified checks as follows:—"

The preceding paragraph, it says, "Amount paid in current year on current calls by the County Treasurer of Yolo County, California, \$123,000.00," and that is for the current year, "less amounts previously paid, \$5,000.00, plus amount not [243] previously accrued on books but paid in the current year," and that is for old calls. It says, "on old calls, old calls didn't meet \$769.00, total \$118,-000.00." That is the findings of the Commissioner of Internal Revenue through his local agent in charge.

Then they list the changes, "amounts allowed in this report consist of four payments in this year by certified checks as follows:" and they list the checks, and they are the four checks in evidence.



Now, we have a duly appointed, qualified and acting officer of Yolo County. We must assume that. He is the County Treasurer, and when a county treasurer makes an assessment, according to law, of a tax, that is a valid tax on the face of that assessment, and for a person to have made that tax, what else could he do? If he didn't, the law will, as I will cite it to your Honor, "The County Treasurer could declare a default, the whole bond issue in default, and come down on the land of the owner against whom the unpaid assessment was made and put the land up at public auction."

In fact, under the law he is obliged to do it. He would be remiss in his duty if he didn't do it.

So this case comes down to just one thing: The whole case is in those four checks, with the call of the County Treasurer of Yolo County, and Mr. Landrum said he got a call for each one of those. They were paid in response to a call from the County Treasurer, the receipts back stating it is to meet the interest on the bonds, and there it is. There is the payment of a tax, and the only thing, then, in connection with it that we need to go into further, is the question of law, and that is the provisions of the Reclamation District Act of California.

There is the Little Case, interpreting a similar Act, such interpretation being by this court.

Now, I was jumping ahead a little bit there. Our Point III was that the Commissioner ought to be estopped by the final report of the Internal Revenue agent in charge, dated December 8, 1947, wherein he held Petitioner entitled to deduct in its return

for the year 1944 assessment paid as taxes in the sum of two hundred twenty-one odd thousand dollars.

Now, the evidence shows that we paid that sum and we gave up our position, original position, in this case, in reliance on that report, and that report wasn't changed until after we did it, until after we made the payment.

In other words, the government got from us, on a position to take it, and upon which we relied, the payment of the assessment, the deficiency assessment that is involved in this case for the year 1941.

Now, there is quite a little text article on Merten's—we lawyers use Merten's—I don't know whether you judges do or not, because it certainly has wonderful textural explanations and analysis of the holdings of the United States Supreme [245] Court, and so forth, and I state the case, in support of the estoppel, I cite several cases, one of them being a United States Supreme Court case, and under a note in Merten's, it states as follows with reference to the Eichelberger case, which is a fifth circuit case, Eichelberger and Co. versus the Commissioner.

In Eichelberger and Company versus Commissioner, 88 F (2d) 874 (CCA 5th 1937), "In which the taxpayer had made a purported sale of property at a loss to another corporation, the stock of which was held by the same stockholders as the transferring corporation, and the Commissioner had disallowed the loss as not being a bona fide sale. The taxpayer accepted his ruling, and in a later year

made an actual sale to a third party, claiming the loss in that year. The Commissioner resisted the deduction on the ground that the sale in 1930 had been valid and the loss sustained then. The Court said: 'He cannot justly decide in 1930 that the sale did not realize the loss and thereby collect increased taxes, and in 1932 decide that it did realize the loss and collect taxes accordingly again. The United States got the benefit of his decision then and ought to abide by it now'."

The United States got the benefit of our giving up our position. It states in this petition in the instant case that we are on an accrual basis, and that then we didn't suffer any loss at a late enough date to be able to wipe out the deficiency [246] for 1941, and we paid it; and then having paid it, they got our \$12,000.00. We ought to be able to rely on their maintaining that position, continuing to maintain it, and that is the position that is stated in this report, and that position is this, reading further:

"The additional net loss as shown in this report is brought about by the allowance in full of amounts paid by the taxpayer in this fiscal year for assessment taxes on Reclamation District 2035."

The Court: What exhibit is that?

Mr. Acret: First report, Exhibit 1, our first exhibit, and, your Honor, listen to this: "Of amounts paid by the taxpayer in this fiscal year for assessment taxes——" that is what they call it "——on Reclamation District No. 2035. A part of the amount paid in this year covers amounts accrued on the corporation books in prior years and dis-

allowed in the prior agent's report as deductions, since the corporation is on a cash basis."

Now, we adopted that. You understand, your Honor, as far as this particular loss in 1944 is concerned, it doesn't make any difference whether it is accrual or cash basis, as I have heretofore stated, because we paid it.

You have an identical situation—we relied on that—they got the money and they ought not be allowed to change their position. [247]

Now, it is true there is no such thing as an estoppel against the Commissioner of Internal Revenue, but in these cases I am about to read, it is pointed out that there is an equivalent of it, and at least the Court will give full credit to the taxpayer's position in such circumstances, strain a point, to say the least.

Here is what the Court says with reference to a somewhat similar situation in *Sugar Creek Coal & Mining Co.*, 31 BTA 344: "Even if the government may not be estopped by the conduct of the Commissioner, as a private litigant may be, and even though it is not bound by an erroneous interpretation of the law by an administrative official, the conduct of the parties to a controversy, including the conduct of the representatives of the government, is entitled to weight where questions of reasonableness of method are involved; and the conduct of the representatives of the government may be such that the Court will resolve doubts in favor of the taxpayer."

That is what I am talking about; when the Com-



missioner takes a position and adopts Judge Turner's opinion and calls this a payment of taxes and says it is deductible and gives us a loss, and on that basis we fall in with it and make the payment, the doubt ought to be resolved in favor of the taxpayer.

That isn't asking too much. I don't mean this to be as harsh as it sounds.

In quoting from Justice Holmes, in the case of *Howbert* [248] versus *Penrose*—that is when Mr. Justice Holmes was in the Circuit Court, the first circuit, 38 F (2d) 577, he says that the government "ought to turn square corners when dealing with its citizens."

It sometimes is appropriate and sometimes, when we represent taxpayers, we find that it gets to be a pretty harsh pulling against us, and this is one of the cases that invokes a little help from your Honor, it seems to me. I believe that it will.

Now, so much for that, on the *res adjudicata* and on the question of estoppel. I believe they are the equivalent of estopped, to take a position different than that in the report.

Now, we have proven just what they found in that report, and we have proven again just what Judge Turner found, and that being the case,—by the way, our Point IV here is the point that the assessment of lands for reclamation purposes is a species of taxation, and I cite a California case. That is just preliminary of what I am going to take up here under Point V, and that is that not only as is set out in the report, but Petitioner, in fact, paid the two hundred twenty-one thousand



to meet taxes of the district, and that if they did, that is a deductible item under Section 23 (c-1) E, such payments are properly deductible as taxes accrued for local benefits properly allocable to interest charges.

In other words, taxes paid for local benefits are an [249] exception and not deductible, but the taxes to meet interest on those local benefits is a proper deduction, and there is a regulation of the department there, Regulation 103 Section 19.23 (c) 3, "Assessments under the statutes of California relating to irrigation, and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefitted, and if the assessments are so limited, the amounts paid thereunder are not deductible as taxes.

"The above statements are subject to the exception that insofar as assessments against local benefits are made for the purpose of maintenance or repair or for the purpose of meeting interest charges with respect to such benefits, they are deductible."

That was what was involved in the Little Case, and they were deducted there as interest and they held they were deductible as taxes. So, that covers that.

Now, the question comes up, which counsel was talking about here, Mr. Birch taking it out of one pocket and putting it into the other. As I pointed out to your Honor, what would appear here, what intervenes is the County Treasurer of Yolo County, and he is obligated to intervene under the Laws of the State of California; so it isn't out of one pocket

into another, but it is through a public agency.

I have on my Point VI here that "The Reclamation District in California is a public corporation for municipal purposes," [250] and I have a citation on it. I think none should be necessary, because it is obvious. It is a municipal corporation, the same as any other, the county; the same in the sense that a street assessment district is.

A thought occurred to me, your Honor, and I hope I am not overdoing myself here or wearing the Court out, but the thought occurred to me there when I spoke up during the course of the trial.

Suppose I owned a lot where there was a street improvement and a street assessment was put in there and a bond issue was put against it and they have proceedings to determine the validity of them. The Court finds them valid and they sell the bonds out to a bank or something and go to the general members of the public. It is a valid street assessment district and it is a valid bond issue when it is issued.

Does that street assessment district and that bond issue become invalid if I should acquire all the rest of the lots in the block, and would it become invalid if a couple of people owned those bonds and I happened to get ahold of them and buy all the bonds?

Just put the proposition. It shows the ridiculousness of it, and that is all we have involved here, and counsel injecting the idea that it was cousins or nieces,—what if it was; how does that change the picture? It is just a different attitude. [251]

When there is a chance to put a burden on a

person for taxes, and particularly a corporation, and it not only isn't fair, but it just doesn't make sense when you analyze it that way.

The next point is Point VII, the Laws of California. It has been held time and again in different cases in California that "The Laws of California are intended to encourage and coerce the reclamation of swamp and marginal lands——"

If you could see—we know in California, know what that stuff looks like up on the Sacramento River. It is a river that carries very heavy flood water and the swamp-land around it is no use for anything, for miles and miles, and the laws of California try to get the people to go in and encourage them to develop them, and they have this Reclamation Act.

If it weren't for that Reclamation Act, there wouldn't be any of that land developed at all; instead they are all developed.

There is one district right after another, all along the Sacramento River, down to Sacramento, and all operating under these Laws.

As Mr. Birch says, they have a bond issue. If they don't pay the first issue, there is a section of the Act that provides they can have a refunding issue, and, as he said, they all do, and the law so provides, and that is the encouragement to be held out and it was so intended. [252]

In *Miller & Lux versus Batz*, and I cite that case: "It is the policy of the State of California to encourage the reclamation of swamp and similar lands."

In the case of Western Assurance Company versus Drain District, 72 Cal. App. 68, 72, and that is a case that is cited, and it goes on to point out the necessity of developing these lands. It says, "The reason that that is so as to Reclamation Districts is because the swamp and overflowed lands of California were granted by the Federal Government to the state upon condition that the latter——" that was with reference to a big reclamation district "——that the latter would see to the reclamation of the same so that they might become suitable for the purposes of cultivation, and, as an essential of corollary that proposition, those who purchase such lands from the state so take them subject to the right, and, in deed, the duty of the state, either by a scheme immediately directed and supervised by itself through officers or agents appointed for that purpose, or by committing that duty to the owners themselves of such lands, to coerce such reclamation according to such rules, regulations and plans as may be prescribed by the state through its legislature." That is exactly what is done here and what happens is that after our government wants more taxes, instead of permitting this beneficent plan to be carried out, the Commissioner of Internal Revenue comes in now with a new position and endeavors to frustrate it. It is a question of whether [253] your Honor is going to permit it to be done. It is an application. It is the duty of the government to turn square corners with its citizens, and we are entitled—this would spoil the effect of the exempt character of those bonds. It is a left-handed way of doing it, by saying our bonds are exempt but



you can't make the deductions, and yet the law says you can make the deductions; money paid as taxes to meet interest on bonds, deductible under the Internal Revenue Code. How can they get around it? They have to get around it by insinuations of nieces and cousins, and silly things like that.

My last point is the matter of these corporations, this incorporation. That didn't change the picture and it is a peculiar thing that Mr. Birch was allowed to make these deductions until he separated the ownership of the lands and the ownership of the bonds. As soon as he did that, the Collector of Internal Revenue thought there must be something special about it, and here is a corporation set up that is really Mr. Birch's alter ego and, therefore, he can't make the deduction, though he could make it before there was any corporation. That is how the whole situation is. You take this next report, the second report. It is just straining to get other than the fact, notwithstanding the fact that counsel stipulated with me, and the fact as to the complete arms' length transaction of Mr. Birch's with the Hopkins and with all these other bond holders. The ownings of bonds over the long period of years was [254] in the hands of not only third parties in transactions at arm's length, but even hostile third parties, and there is no getting around that; those are the facts.

This field agent, in his second report, likens the situation of the Ringe case, with just absolutely no similarity. The Ringe case was where there was



one land owner that made some improvements and got some bonds issued. I think they hardly made any improvements at all, and got about two million dollars worth of bonds issued, and then used them for tax purposes, and there it was held that those bonds were a fiction, but here we have improvements worth more than the amount of the two million dollars, made by Mr. Birch as a contractor. He had a right to be a contractor for the district.

The Court: What did the improvements consist of?

Mr. Acret: We have stipulated, and Judge Turner found, they consist of something like 56 miles of canals, 35 miles of levees, 55 miles of roads. Mr. Birch deeded the lands and the right-of-way to the District, put it absolutely out of its control, just like deeding to the state. It consisted of a site for a warehouse, and I believe a warehouse in itself. The findings on it, the stipulation on it, and everything else, value for value, and the bonds in the hands, as it appears before the Court, were four independent groups of people, some of which were even hostile.

All of the bonds were dealt in in a period of years [255] as bonds at a hundred cents on the dollar, interest paid on them, forced to be paid on them, and as I think Mr. Landrum testified, even interest on interest when the interest was late. It is just ridiculous to have a second report in here, if your Honor will read it, and see what they say about the Hopkins relationship, relationship with the Hopkins, and rely on that as one of the bases

for the deduction not being proper, and what they rely on as to the District being a fiction. It is just utterly ridiculous and there is no similarity between this case and the cases that agent in charge cites there, the Ringe case.

I think, your Honor, I have said all that need to be said with respect to this. If a land owner can ever deduct the amount he pays for taxes, I should think this would be the case where he could do it. I can't think of a time when it would be more legitimate, where that amount of money has been spent and where the bonds were so generally distributed in the hands of the third parties, and in good faith.

In conclusion, I am going to say I am not a tax lawyer, except when a time comes when I have to be for clients like Mr. Birch, but this is the pleasantest tax case I have ever tried, due to your Honor's method of handling it, and I want to express my appreciation.

The Court: Does counsel for Respondent care to make some observations?

Mr. Crouter: Yes, if your Honor please, but I will [256] try to be very brief about, and I would like to know where we stand here as to the briefing question.

The Court: Before you start, we will take a short recess.

(Short recess taken.)

The Court: Will counsel for Respondent proceed.

Mr. Crouter: If your Honor please, as the Court knows, I am merely one of the counsel for Respondent in this case, and under the practice in our office, I am more or less compelled to submit the case on a written brief. I believe, in all fairness and justice to the Court and the attorneys concerned, it should be done in this type of case, so I would like to have leave to file the usual rather complete brief in this case, actually setting forth the Respondent's position.

The Court: The Court expects that to be done, and this innovation, somewhat of an innovation, of permitting a statement of counsel being made at this time, because of the peculiarity of this case, and that it has been tried before three judges, and the Court wanted to get his bearings and find out just where we are before the case is briefed. Of course, the Court will expect argument on the briefs of counsel as to its final determination if he makes it or Judge Kern.

Mr. Crouter: Very well, and with that understanding, and without waiving the right to file the usual written brief, I do not intend to launch into any exhaustive argument about [257] the case, but I would like to comment on two or three phases of it, with the Court's permission.

The Court: The Court would be glad to hear it.

Mr. Crouter: I will address myself chiefly to the points counsel has raised here.

I would refer particularly, if the Court please, to the same points made by the Respondent in the opening statement; in other words, Respondent re-

lies upon the same position asserted and stated to the Court when this proceeding was first called. I tried to be rather specific as to the various points involved and the various positions, legal positions, and contentions, upon which Respondent relies and will rely, and that is still the Respondent's position, if the Court please.

I believe that several of those positions, particularly on the question of identity of interest, the merger of interest between individuals and corporations, and the requirements of the interest statute itself are separate points in the case, and, as I see it, those are separate legal hurdles that the Petitioner must get over in order to be entitled to the deductions that the Petitioner claims, particularly for the year 1944, and I also mention again the net loss carryback statute. That has its own requirements and exceptions and limitations, and I will attempt to point out just as clearly as I can, and under separate headings, the various statutes and cases relied upon by the Respondent, and I may say that in spite of very [258] earnest and vigorous argument by my friend Mr. Acret, he has not yet convinced me at all that any of those points lack any of their merit.

I would like to call to Mr. Acret's attention, and to the Court's attention also, two matters that did occur in the proceedings before Judge Kern, which is, as I understand it, a part of the record in this case and will remain for the Court's disposition of the issues pending now.



To answer the Court's question, there were no witnesses at the hearing before Judge Kern. That was held on June 30, 1947. The transcript contains 51 pages. There were three exhibits offered and a good deal of proceedings there consisted of colloquy between the Court and counsel to determine the posture of the case and to determine what the issues were and what it required. Now, I will also like to point out, at pages 25 and 31——

The Court: The transcript before Judge Kern?

Mr. Crouter: Yes, the transcript of June 30, 1947, before his Honor Judge Kern, at page 25 in my statement before the Court at that time, I stated in part as follows, when these same questions were under consideration:

“Now, it is contended for administratively——” and I was talking about the carryback question and the tax deduction “——administratively, and has been under consideration administratively, that is not final. It is not conceded that the [259] Petitioner is entitled to those deductions as counsel said, the statutes are still open. That is still a matter for the Bureau of Internal Revenue for the prior years, 1941 and 1942.”

Then, I believe Judge Kern grasped the situation at that time, because he said, among other things, at page 31 of the transcript:

“The Court: May I interrupt again, Mr. Crouter. I am sorry to interrupt. I want to get these things straightened out. When you are speaking about the Respondent's position, you are speaking about the Respondent's position as you know it at this time,



and not with reference to the Revenue Agent's report which is referred to by Mr. Acret."

"Mr. Crouter: That is correct."

Now, my only reason for mentioning that, if the Court please, is particularly on account of the date being June 30, 1947, which, of course, was a little while before the payment was made.

The Court: What was the date of the payment?

Mr. Crouter: The 1941 tax. However, as I said, that question, if the Court please, the 1941 year, is still open and pending in this proceeding, and that may indicate the wisdom of the Congress and the people that framed the procedural provisions with respect to the Board of Tax Appeals and the Tax Court. They apparently had the view that every year before [260] the court should be kept open until there was a final decision which finally disposed of everything for these years, so the year 1941 is still in this proceeding, and as shown by the Collector's records, there has been no final assessment for that year. So anything the Petitioner has or offered or contended with respect to the merits of the 1941 tax, it seems to me is still in the case.

The Court: What was the date of the payment of the 1941 tax?

Mr. Crouter: As I recall, that was July 7, 1947.

Mr. Acret: Right after the hearing.

Mr. Crouter: Just about one week after the hearing.

Now, as to that matter, if the Court please, I would rather answer it fully on brief, this question of estoppel by a prior revenue agent's report. I

was very much interested in counsel's argument, because that is a question which very frequently and unfortunately arises, that there will be more than one agent's examination and report for a year. To me, it has all the appearance and earmarks and the actuality of setting up a straw man and then destroying him, because the Courts have held time and again, the Tax Court and the higher Federal Courts, that certainly the sovereign United States, and that is something beyond all of us, that is the country itself, is never estopped, and its rights are never lost, and they are never prejudiced by the action of some lower administrative officer in [261] the employ of the sovereign. That is a bridge which the Supreme Court and various other Courts have crossed. The Supreme Court has held that even the Commissioner himself is not estopped or bound by a prior inconsistent determination of his own, or his predecessor in office, unless that is carried out and it becomes embodied in a court decision where the doctrine of *res adjudicata* really applies or it is the subject of a final closing agreement. There is just a very limited field of exceptions to that rule, as I recall, so that it seems to me counsel is really leading himself astray when he pins too much of his case upon the first Revenue Agent's report; that we are confronted here with the issues squarely drawn in the pleadings, and also as shown by the second Agent's report, a part of which the Petitioner has offered to the Court, to show that the Commissioner finally did not pass these deductions;

he did not allow them; he disallowed those deductions for various reasons stated and for various reasons which we have submitted to the Court here.

Now, if it is agreeable to your Honor, and without going into any extending argument on the merits of this case, I would much prefer and believe I could do it more consistently on brief. However, I am prepared, and I don't care to shirk my duty. I am prepared to go. I have my prior brief, quotations, and state authorities, but I really would prefer to do it the other way if that is agreeable to the Court. [262]

The Court: It is agreeable to the Court.

Mr. Acret: Will it be agreeable to the Court—I believe our points and authorities are adequate to submit that as our brief at this time.

The Court: You mean, as your opening brief?

Mr. Acret: As my opening brief, yes. I think your Honor will find it covers the situation.

The Court: In other words, you desire to have the statement which you have made as your opening brief in this case and then let Respondent reply to that and let you reply to his brief?

Mr. Acret: Well, it was the statement I made, together with the points and authorities which I filed at the outset of the case.

The Court: In other words, you think you would be willing to waive the formality usually practiced of filing an opening brief, and permit the oral statement made this afternoon to be accepted as your brief?

Mr. Acret: Yes, your Honor, that is, assuming

that will be satisfactory to the Court. I want to do all in my part.

The Court: What does Respondent's counsel have to say?

Mr. Crouter: That is satisfactory to me. Respondent could file a reply brief. [263]

The Court: That would expedite the filing of briefs, because the Petitioner's brief would already be filed. I guess the seriatim brief, then,—how long would Respondent's counsel want in which to prepare?

Mr. Crouter: I would like 50 days, if the Court please, on account of the transcript and other briefs I have also.

The Court: Petitioner's counsel, in his statement it might be well for him to give any citation authorities. I think he did.

Mr. Acret: They are all in and I have loaned the reporter my copy of the points and authorities, and I just have one or two remarks to make in response to counsel.

Mr. Crouter: I wonder if we can establish the due brief dates.

The Court: Did you say 50 days?

Mr. Crouter: Yes, if the Court please.

The Court: What would that be, 50 days from today?

The Clerk: It will be April 6th.

The Court: And then would Petitioner want 30 days thereafter?

Mr. Acret: That is what I was going to suggest.

The Court: 30 days thereafter in which to make



his reply brief. April 6th doesn't fall on a Saturday or Sunday, does it? [264]

The Clerk: No, Wednesday.

The Court: What would 30 days after April 6th be?

The Clerk: May 6th, on Friday.

The Court: Those days will be fixed as the dates in which the briefs, respective briefs, will be filed.

Now, did Petitioner's counsel wish to add something to what he said?

Mr. Acret: Yes, if your Honor would permit.

The Court: Yes, the Court would be glad to hear it.

Mr. Acret: And that is more on this question of estoppel. I appreciate ordinarily exactly what counsel says is true, that these reports are not final in any degree, but it must be, should be kept in mind that that report is what we responded to at the time this case was called for trial before Judge Kern, and in view of its existence, and the fact alone that it took the position that we were on a cash basis, I made, I confess, the assessment, the deficiency assessment, that is involved in this case for 1941, and there was nothing before the Court at that time but that deficiency assessment, and there still is nothing, nothing any different, and we have confessed it and we paid it for 1941. In other words, there was never anything to the contrary ever entered my mind, that if we did that there wouldn't be any question but what we would be allowed to rely on this being on a cash basis, and that loss was stated in that report. It never occurred to me as



a [265] possibility that when we did that, then they would come in and make another audit. There wasn't any reason for it, never even a suggestion that would be done, and I got the surprise of my life.

The Court: How long after that payment was made before another audit?

Mr. Acret: That audit didn't come in until months after. There was never a suggestion that anything like that was going to be done. You see, that audit didn't come in until the following December of that year.

Mr. Crouter: I believe that is the date of record, isn't it, and naturally the investigation all precedes the writing up.

Mr. Acret: That may be, but the reports and investigation didn't start until afterwards, but it never entered my mind.

The Court: That report, audit, came in, the amount was increased?

Mr. Acret: The first report increased our loss from eighty-four thousand to a hundred and eighty-six, on the ground we had a right to make these deductions and that we had suffered that loss.

Then, the next report comes along and disregards Judge Turner's findings of fact to which they referred in the first report, and says just the opposite of Judge Turner's [266] findings of fact, that this is a fiction, and classed us as having a gain instead of a loss in 1944, but they state in that report, the gain, we don't pay any taxes on it because we can carry back a loss for still a later year to wipe out

that gain. They make us come out even. It was just a clever thing that made us come out even for 1944, instead of leaving us this to fall back on. That is the situation. I didn't think I would be dealt that way by the Department of Internal Revenue.

The Court: I suppose that concludes the statements of counsel and the Court thanks counsel for the cooperation and assistance in this rather complicated and difficult matter, and appreciates also the fact that the opening brief has been filed, which will expedite the consideration of the case by the Court.

I believe that concludes the docket and all matters pertaining thereto at this session, the Court at the Los Angeles setting, so we are now finally adjourned sine die.

(Whereupon, at 3:35 o'clock p.m., Tuesday, February 15, 1949, the hearing in the above-entitled matter was closed.)

Filed T.C.U.S. March 8, 1949. [267]

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[Title of Tax Court and Cause.]

## STIPULATION TO CORRECT TRANSCRIPT

It is hereby stipulated by respective counsel in the above-entitled proceeding that the transcript of record at the hearing held on February 11 and 15, 1949, may be corrected as follows:

Page 28, 17th line, change "now" to "not"

Page 32, 21st line, change "provide" to "deprive"

Page 36, last line, insert comma after "allowed" and change "They" to "or"

Page 42, 20th line, change "agents" to "acts"

Page 43, insert "every year" after "litigated"

Page 67, last line, change "collectible" to "taxable"

Page 117, second line, add "assessment" after "prohibit"

Page 138, 16th line, change "staff" to "Stout"

Page 223, 22nd and 23rd lines, change "expense" to "suspense"

Page 224, 4th line, change "expense" to "suspense"

Page 237, 21st line, change "foreign" to "farm"

Page 238, first line, change "plain" to "claimed"

Page 262, 7th line, change "where" to "or"

/s/ GEORGE ACRET,

Counsel for Petitioner.

/s/ CHARLES OLIPHANT, ECC

Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Received and Filed T. C. U. S. May 2, 1949.

The Tax Court of the United States

B.T.C. No. 122

BIRCH RANCH & OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 8720

Promulgated December 15, 1949.

## FINDINGS OF FACT AND OPINION

A taxpayer corporation, keeping its books on the cash basis, owned substantially all land comprised in a California reclamation district. The district had outstanding 2,000 6 per cent bonds of \$1,000 face value each, payable from the proceeds of improvement taxes assessed against the land. The taxpayer and the taxpayer's sole shareholders, husband and wife, and holding companies wholly owned by the shareholders held 1,680 of the district's bonds at the beginning of the fiscal year 1944 and acquired 310 more about the middle of the year. To pay interest on the bonds, the reclamation district, through the County Treasurer, made assessment calls which petitioner paid during the year, and deducting such payments as taxes, it computed a net operating loss for fiscal 1944 which it claims as a carry-back deduction for fiscal 1942.

1. A revenue agents' report, addressed to the taxpayer, in which the tax payments were allowed

as deductions, held, not to estop the Commissioner from defending a subsequent determination that the taxpayer had no net operating loss for fiscal 1944 and consequently no carry-back, such determination being based on a disallowance of the deduction of tax payments.

2. Amounts paid on call of the County Treasurer as taxes to meet interest on bonds of a California public reclamation district, held, deductible by the taxpayer although it owned all the land assessed and its sole shareholders owned or controlled a majority of the bonds, the minority bondholders having a material number of bonds. *Rindge Land & Navigation Co.*, 2 B.T.A. 1179, distinguished.

George Acret, Esq.,

For the petitioner.

Earl C. Crouter, Esq.,

For the respondent.

The Commissioner determined deficiencies of \$7,833.44 and \$11,915.67 in petitioner's income taxes for the fiscal years ended September 30, 1941, and 1942, respectively, and deficiencies of \$4,565.41 and \$1,687.10 in declared value excess-profits taxes for those respective years. In the original petition error was assigned in the determination that petitioner's books were kept on the cash basis, not on an accrual basis, and in the consequent disallowance of deductions claimed by petitioner on account of accrued taxes, payable but unpaid, to a California reclamation district. In a proceeding involving the fiscal



years 1937 and 1939, Docket No. 109993, this Court decided like issues adversely to petitioner's contention while this case was pending, and after affirmance of that decision on appeal petitioner abandoned those assignments and amended its petition to claim a carry-back deductible in fiscal 1942 because of an alleged net operating loss sustained in fiscal 1944. The Commissioner allowed no carry-back deduction, having computed a net income of \$34,711.50 for fiscal 1944. In so doing he did not allow the deduction of taxes of \$221,610.87 actually paid to the reclamation district in that year on the ground that petitioner owned all the land of the district and it or its stockholders owned substantially all the bonds of the district so that petitioner's obligation to pay taxes and the district's obligation to pay interest on the bonds was lacking in substance. Petitioner contests the disallowance and the resulting determination that there was no net loss carry-back available as a deduction for fiscal 1942 under section 122(b), Internal Revenue Code. In a Memorandum Opinion entered March 24, 1948, it was held over respondent's objection that this Court had jurisdiction to decide the issue so raised. The case was submitted on a stipulation, which we hereby incorporate by reference as findings of fact, on oral testimony and on exhibits.

### Findings of Fact

Petitioner, a Nevada corporation with principal office at Los Angeles, California, filed its income tax returns for the fiscal years ended September 30, 1941,

1942 and 1944 with the collector of internal revenue for the sixth district of California. Petitioner was organized on October 15, 1934, by A. Otis Birch and his wife, M. Estelle C. Birch, who transferred to it a 21,000 acre tract of land known as the Conaway Ranch and certain other property. On the same date Birch and wife also organized the Birch Securities Co. (hereafter called Securities) as a Nevada corporation and transferred to it 1,594 bonds, each of \$1,000 face value, issued by Reclamation District No. 2035 (California), certain stocks and other assets. The two transfers comprised all of their property. On the same date they also organized the Birch Holding Co. (hereafter called Holding); all shares of petitioner and Securities were transferred to it, and it issued 49 per cent of its shares to Birch and 51 per cent to Birch's wife. Birch was president and in control of the affairs of all three corporations. Securities and Holding were formed for convenience and conducted no business. Petitioner operated the Conaway Ranch, raising and selling crops and sheep.

The Conaway Ranch is situated in Yolo County, California, about five miles from Sacramento. It was purchased in 1914 and thereafter enlarged by the Birch Oil Co., a partnership in which petitioner and his wife, the wife's parents, and Birch's nieces, hereafter called the Hopkins sisters, held interests. At the time of the initial purchase the Sacramento and San Joaquin Drainage District, created under the laws of California, was making surveys in the area for a flood-control project, and the Reclama-

tion Board of the state later informed the Birch Oil Co. that if it would construct a levee across the ranch adjacent to a proposed Yolo By-Pass, an assessment would be made against all lands in the drainage district to pay for the construction and for flowage rights. Desiring to develop its land, Birch Oil Co. later petitioned the Supervisors of Yolo County to create a reclamation district which would comprise the ranch, and in April 1919 the Supervisors approved the establishment of Reclamation District No. 2035. B. F. Conaway, Birch's father-in-law, C. Harold Hopkins, the husband of Birch's niece, and a local attorney were appointed district trustees. A program of improvements, estimated to cost \$2,264,740, was authorized, and commissioners were named who apportioned the cost of the improvements among lands in the district according to the benefits to be received and filed with the Treasurer of Yolo County assessments against the lands to meet such cost.

The Birch Oil Co., under direction of the district's engineer, constructed the improvements, which consisted of many miles of roadways, canals, ditches, bridges, pumping plants and other structures, at a cost of slightly over two million dollars. It financed the work, and after completion in 1924 received a warrant, dated January 5, 1925, directing that the district, through the Treasurer of Yolo County, pay it two million dollars. On January 23, 1925, 2,000 bonds of the district, each of a par value of \$1,000, were offered at auction to provide the necessary funds, and Birch purchased all of them.

giving the \$2,000,000 warrant in payment. These bonds bore 6 per cent interest payable on January 1 and July 1 of 1925 and each year thereafter on presentation of an interest coupon to the County Treasurer; 227 bonds were to mature on January 1 of 1935 and a like number on January 1 of each succeeding year, ending with maturity of the last 184 on January 1, 1943. Principal and interest were payable out of moneys collected by the Treasurer of Yolo County from assessments against the benefitted lands, which assessments were to be deposited "into the main county treasury" but "credited to the bond fund" of the district, as provided by section 3480, art. II, ch. 1, Title 8, Deering's Political Code of California.

Pursuant to a contract of 1924 Birch and wife purchased the Hopkins sisters' interests in the ranch and Birch Oil Co., and in 1926 they purchased the wife's parents' interest. By virtue of these acquisitions and the purchase of small adjacent parcels of land they came into ownership of the entire ranch, then consisting of about 21,000 acres. The ranch was co-terminous with Reclamation District No. 2035 except for 1,300 ranch acres which lay outside the district and 240 district acres which lay outside the ranch. In buying the interests of the Hopkins sisters, Birch paid them \$1,000 cash and 786 district bonds. Simultaneously he and his wife agreed to buy back from them the 786 bonds at face value in specified annual installments on January 1 of each year from 1926 to 1934, and as security for performance they placed their remaining 1,214 bonds



with trustees empowered to sell and make good any default by them on the contract. The Hopkins sisters, however, reserved the right not to sell on any installment date. During the first six years petitioner and wife paid for and received 476 bonds, as contemplated by the contract. Because of financial difficulties they thereafter ceased to purchase installments of the remaining 310. But instead of invoking action by the trustees the Hopkins sisters granted them a time extension without release from the obligation to buy. Prior to 1937 petitioner and wife sold 10 of their district bonds to Lula Minter, a cousin of Birch, and 86 to the Great Republic Life Insurance Co., of which Birch was president and a director.

During the years 1925-1930 Birch and wife paid to the County Treasurer of Yolo County on call of the assessment against the ranch the amounts necessary to meet interest payments on the bonds, and the Hopkins sisters collected their interest from the Treasurer on presentation of the matured coupons. In succeeding years Birch bought the coupons of the Hopkins sisters as they matured, and deposited them with the Treasurer, receiving a receipt and credit on the assessment against the ranch. After petitioner acquired the ranch in 1934, it too purchased at face value matured interest coupons from the Hopkins sisters and from Lula Minter, turning them in to the County Treasurer. It did not buy matured coupons on the 86 bonds held by the insurance company, and that company's successor in interest eventually brought suit to enforce collection



of interest. The suit was settled by petitioner's purchase of the 86 bonds and accrued interest in 1940 for \$65,000.

No amount was ever paid into the reclamation district by Birch and his wife or by petitioner for the purpose of paying off the bonds. But prior to maturity of the first 227 and in 1935 the original issue was refunded by 2,000 new 6 per cent bonds of \$1,000 face value, of which 50 were to mature on January 1 of 1945 and of each succeeding year. To test the legality of the original issue the district trustees filed a complaint with the Superior Court of Yolo County, and after consideration of the evidence the court on March 2, 1925, entered a decree that:

\* \* \* said bonds are a valid, legal obligation of said Reclamation District No. 2035, \* \* \*

The refunding bonds were likewise held a legal obligation of the district by decree entered in a similar proceeding on June 25, 1935. The proceedings were not contested.

Since organization petitioner has operated the Conaway Ranch, and has borne all costs and expenses of maintaining and operating the improvements of the reclamation district, treating such disbursements as part of its expenses in operating the ranch in a manner which would be no different if there were no reclamation district, whether formal or actual, and the district has no expenses which are not taken care of by petitioner. For its ranch operations petitioner keeps a set of books on the basis of cash receipts and disbursements.

The officials of California counties are lenient with the owners of assessed lands in reclamation districts, and while there was no express agreement, the Treasurer of Yolo County refrained, in and after 1937 from making any calls on petitioner for payments or declaring defaults or taking foreclosure action against the ranch, being aware that petitioner was in no position to pay an assessment. Petitioner nonetheless accrued on its books and deducted on its income tax returns an amount of \$120,000 a year for which a call could have been made to provide the County Treasurer with moneys necessary for the payment of the annual 6 per cent interest on the \$2,000,000 face value bonds. It continued to buy at face value the maturing interest coupons on the 310 bonds of the Hopkins sisters and the 10 bonds of Lula Minter, paying \$18,600 and \$600 a year, respectively, for them. The Commissioner allowed a deduction of the \$600 paid to Lula Minter, but disallowed the rest of the \$120,000 claimed. Petitioner contested such disallowances for 1937 and 1939 in a proceeding before the Tax Court, Docket No. 109993. The Court held that the \$18,600 paid to the Hopkins sisters was deductible, and sustained disallowance of the rest. Memorandum Opinion entered April 20, 1944, affirmed by the Circuit Court of Appeals for the Ninth Circuit on January 6, 1946, 152 Fed. (2d) 874. This decision was based on a finding that petitioner kept its books for ranching operations on a cash, not an accrual basis, and had made no payments other than the \$600 and the \$18,600.

On September 30, 1943, petitioner held the 86 bonds acquired from the life insurance company; Securities held the 1,594 transferred to it at organization; the Hopkins sisters held 310 subject to the sale contract with Birch and wife, and Lula Minter held 10. On March 15, 1944, Birch and wife bought the remaining 310 bonds from the Hopkins sisters, and before the close of the fiscal year on September 30 Securities was liquidated and dissolved. Securities had been suspended since 1938 for failure to pay a state tax. Thus at the close of the fiscal year 1944 Birch and wife held directly 310 of the 2,000 bonds of the district; Holding held 1,594 from the liquidation of Securities; petitioner held 86, and Lula Minter 10. In March 1943 petitioner, Birch and wife gave to several individuals a written option to purchase the Conaway Ranch and all the district bonds.

During the period 1937 until late in 1943 petitioner made no cash payments to the County Treasurer to provide interest on the bonds and received no call to make a payment. In 1943, however, funds became available to it, and on October 13, 1943, the Treasurer made a call for \$58,565.92, payable November 12. Petitioner advised the Treasurer that it could not pay the amount until later and would submit to a delinquency penalty. In reply the Treasurer explained that the penalty was "part and parcel of the Call," which was "for interest only." On December 28, 1943, Securities transmitted to the Treasurer coupons from 166 bonds and advised that the trustees for the Hopkins sisters would present

coupons from 1,278 bonds. It requested remittance of \$49,320 to cover the accrued interest. The following day petitioner paid the assessment call and a penalty of \$5,856.59 by its check for \$64,422.51 drawn in favor of the County Treasurer, and the Treasurer remitted \$49,320 interest to Securities on January 8, 1944. On April 10, 1944, the Treasurer made another call for \$53,721.65 payable May 10. Petitioner paid this call and a 10 per cent delinquency penalty of \$5,371.94 by its check for \$59,093.59 dated June 28, 1944. On August 12, 1944, petitioner gave to the Treasurer its check for \$37,325.28 in satisfaction of the unpaid portion of a call dated December 1, 1935, together with penalty. Before making this remittance petitioner inquired of the Treasurer by letter if the Treasurer would pay the interest coupons in arrears upon receipt of the amount. On September 20, 1944, it paid the Treasurer \$60,769.49 in satisfaction of a call dated September 8, 1944. In making calls, the treasurer computed an amount which, with any balance on hand, was sufficient to provide \$60,000 for the semi-annual interest due on the bands, and amounts paid as penalties were reflected in his computations. The four payments which petitioner made during its fiscal year 1944 aggregated \$221,610.87. Soon after the collection of money by call the Treasurer paid interest on the bonds, but no interest was ever paid without such preceding collection.

On its tax returns for the fiscal years ended September 30, 1941 and 1942, petitioner claimed a deduction of \$120,000 on account of the tax due Rec-



lamation District No. 2035; for each year the Commissioner disallowed the deduction "except as to \$19,200 paid to the Hopkins sisters and Miss Minter." After affirmance of this Court's decision in Docket No. 109993 and on July 7, 1947, petitioner paid to the collector \$12,398.85 on account of the deficiencies determined in its income and declared value excess-profits taxes for the fiscal year 1941. As there had been no assessment of the determined deficiencies, the payment was credited by the collector to a suspense account and not applied in satisfaction of a tax. On its return for the fiscal year ended September 30, 1944, petitioner claimed a deduction of \$118,890.87 as taxes paid to Reclamation District No. 2035, and reported a net loss of \$84,179.37 for the year. In a report dated January 23, 1947, addressed to petitioner, the revenue agent in charge of the Los Angeles Division recomputed a net loss of \$186,899.37 for the year, and in so doing, allowed a deduction of \$221,610.87, or the amount actually paid to the Treasurer of Yolo County on account of the district taxes and penalties. In a subsequent report, dated December 8, 1947, deduction of the \$221,610.87 was disallowed on the ground that:

\* \* \* there was no real or actual obligation outstanding against the taxpayer, since Reclamation District No. 2035 was comprised exclusively of the taxpayer's property, and since A. Otis Birch and his wife, Estelle Birch, the sole stockholders of the Birch Ranch and Oil Com-



pany hold substantially all the bonds of the Reclamation District.

\* \* \*

As the interest received by A. Otis Birch and his wife, Estelle Birch, is non-taxable, the amounts claimed as taxes paid by the Birch Ranch and Oil Company is considered non-deductible.

As a consequence of this disallowance the Commissioner determined that petitioner had no net loss carry-back from the fiscal year 1944 to the fiscal year 1942.

### Opinion

Johnson, Judge:

Petitioner charges the Commissioner with error in failing to allow the deduction of a net operating loss carry-back in the computation of its income and declared value excess-profits taxes for the fiscal year ended September 30, 1942, by virtue of a net operating loss of \$186,899.37 sustained by it for the fiscal year ended September 30, 1944. Originally petitioner also assigned as errors the Commissioner's disallowance of the unpaid portion of a deduction of \$120,000 claimed on each of its returns for the fiscal years 1941 and 1942 as accrued taxes payable by it to Reclamation District No. 2035. When the petition was filed, a similar issue was pending before this Court in Docket No. 109993, involving petitioner's right to deduct the same accrued liability of \$120,000 for each of the fiscal years 1937 and 1939. This Court's holding that petitioner's books were kept on a cash basis and that it was entitled to de-

duct only the \$18,600 paid to the Hopkins sisters and the \$600 paid to Lula Minter was affirmed by the Circuit Court of Appeals for the Ninth Circuit on January 6, 1942, as reported in 152 Fed. (2d) 874.

At the first hearing of this proceeding on June 30, 1947, petitioner, accepting the holding that its books were kept on the cash basis, conceded that there were deficiencies in tax as determined for its fiscal years 1941 and 1942, but asked the Court to provide in its order that the tax liability for fiscal 1942 be computed to reflect the carry-back of losses sustained by it in fiscal 1944. Rejecting respondent's contention that a decision of deficiencies in the amounts determined be entered without adjustment for any carry-back, this Court in a Memorandum Opinion entered March 24, 1948, took note that petitioner's right to a carry-back was properly raised as an issue and held that such issue was a proper subject for decision. Petitioner then moved to reopen the case for the purpose of presenting evidence relative to its net operating loss for fiscal 1944. This motion was granted, and petitioner thereafter amended its petition to make allegations concerning the payments made to the County Treasurer and to plead that the respondent was estopped to deny the deduction of these payments in fiscal 1944. The issue thus raised for decision requires a determination of petitioner's right to deduct as taxes in fiscal 1944 the \$221,610.87 which it paid in that year to the Treasurer of Yolo County on calls under the

tax assessment of the reclamation district against the Conaway Ranch.

In a report dated January 23, 1947, addressed to petitioner, the revenue agent in charge of the Los Angeles Division allowed the deduction in question and computed a net operating loss of \$186,899.37 for fiscal 1944. Petitioner now argues on brief that since it paid the deficiencies of \$12,398.85 determined (but not assessed) for fiscal 1941 in reliance on this report, respondent should be estopped from denying it the advantage of the carry-back deduction therein recognized as allowable for fiscal 1942, which deduction it anticipated in making the payment. The agent's first computation was reversed, however, and in a later report, dated December 8, 1947, the payment of the \$221,610.87 was not allowed as a deduction with the result that the net loss of fiscal 1944 was converted into a net income of \$34,711.50. As a consequence the Commissioner determined that there was no loss carry-back from fiscal 1944 available as a deduction for fiscal 1942.

We fail to perceive in the Commissioner's action any basis whatever for an estoppel. The amount of the deficiency for fiscal 1941 was in no wise affected by any deduction on account of a loss carry-back to which petitioner might or might not be entitled for fiscal 1942. Petitioner had no right, under the decision in Docket No. 109993, to deduct in fiscal 1941 taxes due to the reclamation district which it had accrued but not paid. It so admits by abandoning all issues relating to fiscal 1941. There was hence no issue raised for fiscal 1941 about which the

Commissioner's action could have misled petitioner, and in any event the payment was not applied to the 1941 deficiencies, which have not yet been assessed, but was placed in a suspense account.

By section 23(c) (1), Internal Revenue Code, taxes paid or accrued within the taxable year are deductible except:

(E) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges; \* \* \*

As all of the \$221,610.87 paid to the County Treasurer was for application to interest charges, none of it is excluded as a deduction by the statutory exceptions, and respondent does not contend that it was. Its disallowance was explained in the agent's second report as follows:

This disallowance is based on the fact that there was no real or actual obligation outstanding against the taxpayer, since Reclamation District No. 2035 was comprised exclusively of the taxpayer's property, and since A. Otis Birch and his wife, Estelle Birch, the sole stockholders of the Birch Ranch and Oil Company hold substantially all the bonds of the Reclamation District.

Section 23 of the Internal Revenue Code states:

Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(b) Interest—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations \* \* \* the interest upon which is wholly exempt from taxes by this chapter.

(c) Taxes—Generally.

(1) Allowances in General—Taxes paid or accrued within the taxable year except—

(a) taxes assessed against local benefits of a kind tending to increase the value of the property assessed.

As the interest received by A. Otis Birch and his wife, Estelle Birch, is non-taxable the amounts claimed as taxes paid by the Birch Ranch and Oil Company is considered non-deductible.

Respondent, now defending the disallowance on both the above grounds, argues first that the Birches, the petitioner and the reclamation district were all one and the same in substance since petitioner owned all the assessed land in the district, the Birches through Holding owned all the stock of petitioner, and they and petitioner owned substantially all the bonds of the district. On this background he reasons that in effect the same party paid the taxes in controversy and received the tax-exempt interest



which those taxes supplied. He urges that under such circumstances the district should be ignored for tax purposes as a legal fiction, and that the tax and interest payments should be disregarded as not having any business purpose and not discharging any real legal obligation.

To buttress this view, respondent cites numerous sections of the Political Code of California, Part 3, Title 8, chapter 1, article 2, relating to reclamation districts, pointing out that section 3472 authorizes the formation of a district without the intervention of trustees by parties owning all the land affected; that section 3480 empowers the landowners of those districts which are under trustees to authorize bonds by vote; requires that 10 per cent of any bonds issued be retired within ten years of issuance; that a fund be created for such retirement; that parcels of land be sold to provide delinquencies in assessment payments; that the district's bonds may be used in satisfaction of assessments; and that section 3493 permits owners of 50 per cent of the land to dissolve the district. He concludes that Reclamation District No. 2035 was in fact if not in form a private district; that in actual operation it was treated as a private district because no assessment taxes were paid from 1937 to 1943; no sinking fund was created, and the fiction of a public district was artificially kept alive to the end that petitioner might deduct the amount which it paid as taxes and which it or its sole stockholders received back as tax-exempt interest.

The essential factual premises or inferences which respondent assumes for this argument are not adequately supported by the evidence. We can disregard as negligible the 240 district acres which petitioner did not own and against which an assessment for bond interest apparently was not made, but we can not lightly ignore a public district invested with taxing powers and other sovereign attributes and the substance attaching to the very large number of bonds which were held by parties who had no identity of interest with the Birches and whose right to bond interest was consistently observed,—in one case, after threat of suit. The Hopkins sisters acquired 786 of the 2,000 bonds in 1925; they owned 310 from 1931 to March 15, 1944, or during five and a half months of fiscal 1944. At an undisclosed date the Birches sold 86 bonds to the Great Republic Life Insurance Co., and its successor sold these bonds to petitioner in 1940; the Birches sold 10 bonds to Lula Minter who held them throughout fiscal 1944. Petitioner regularly paid to the Hopkins sisters and to Lula Minter the amount of accrued current interest due them, receiving and turning over the interest coupons to the County Treasurer. By so doing it acquired a credit in the same amount on the district's assessment for interest. See section 11, article II, chapter 1, Title 8, Part 3, Political Code of California, and hence it is not technically correct to say that no assessment taxes were paid from 1937 to 1944. An amount of \$19,200 was paid each year, and by this Court's decision in

Docket No. 109993 the amounts so paid were deductible.

Without formally pleading *res judicata*, petitioner argues on brief that the recognizable character of the district and petitioner as separate entities is in fact *res judicata* by virtue of our holding in the prior proceeding. While that decision, involving the fiscal years 1937 and 1939, would not here support the plea, if made, see *Commissioner v. Sunnen*, 333 U.S. 591, we deem the facts therein considered so nearly identical with those existing in fiscal 1944 as to require the same conclusion previously reached. To view the tax assessment as paid by the same party which received the bond interest, it is not enough to identify petitioner, Holding and Securities with Birch and his wife. It is also necessary to identify with them the reclamation district, and this district is by state law:

\* \* \* a public, as distinguished from a private, corporation. It acts as a state agency invested with limited powers, \* \* \*. [*Metcalf v. Merritt*, 14 Cal. A. 244; 111 Pac. 505]

Respondent cites *Rindge Land & Navigation Co.*, 2 B.T.A. 1179, and the very similar case of *California Delta Farms, Inc.*, 6 B.T.A. 1301, as decisions in which a similar district was for tax purposes identified with the sole landowner in it. In the former case the sole landowner, a corporation, had caused the district to issue to it a warrant for an amount in excess of the cost of property which it transferred to the district, and had used that warrant to

procure all the district bonds which bonds it gave to creditors in place of certain indebtedness of its own. The Board of Tax Appeals refused to recognize the excess of the warrant over the property as resulting in taxable gain, but in so doing, expressly confined its "discussion and decision to the particular facts." As those facts indicated that the taxpayer owned all the district and procured all the bonds, obviously no third party's interest was involved and the price named for the property was admittedly arbitrary and designed to further the taxpayer's debt refunding scheme. As the issue related only to a sale between the landowner and the district, moreover, the legal incidence of bonds and assessments was not even involved. But the intervention of even a small interest by third parties has been deemed to preclude a disregard of the separate character of a public district. In *Kings County Development Co.*, 27 B.T.A. 1291, the taxpayer's gain on a sale of property to a reclamation district was held taxable even although the taxpayer owned 80 per cent of the district land. In so deciding, the Board expressly recognized that:

\* \* \* Such districts are separate and distinct legal entities from the land owners within the district, \* \* \*.

Respondent correctly asserts that in numerous cases deductions such as interest have been held unallowable where it appeared that the payor and payee were economically identical, e.g., *Prudence Securities Corporation v. Commissioner* (C.C.A.,



2nd Cir.), 135 Fed. (2d) 340; Marian Bourne Elbert, 45 B.T.A. 685. But the decisions on which he relies do not involve tax assessments of a public corporation or interest payable on its bonds, a substantial number of which were owned over the years by parties having no identity of economic interests with the taxpayer. We have already held in Docket No. 109993 that the amounts which petitioner supplied in satisfaction of interest on bonds held by the Hopkins sisters and Lula Minter were deductible. The Hopkins sisters continued to own bonds during nearly half of fiscal 1944 and Lula Minter owned 10 during all of it. That part of petitioner's assessment payments used to pay interest on their bonds is obviously deductible under the prior decision. Should a distinction be made in regard to the tax applied to interest payments on petitioner's bonds? We think not. The funds which the district collected by its assessment calls were for the payment of interest in general, and we are of opinion that petitioner's right to deduct its payments as a tax is not defeated by the fact that a part of such payments became available to pay interest on bonds held by it, by Securities, by Holding, or by the Birches. *Andrew Little*, 21 B.T.A. 911.

Respondent argues further that the "payments of interest on reclamation bonds" was the payment of interest on indebtedness incurred and continued to purchase and carry tax-exempt obligations, and hence such payments are not deductible under section 23(b), Internal Revenue Code. Recognizing



the reclamation district as a legal entity, we view petitioner's payments as made in satisfaction of taxes, not of interest, and the argument thus lacks factual foundation. As taxes assessed for interest only, they are not of a kind tending to increase the value of the property assessed, and are hence properly deductible. *Mary E. Evans*, 42 B.T.A. 246; *Missouri State Life Insurance Co.*, 29 B.T.A. 401; *Andrew Little*, *supra*.

We hold that the Commissioner erred in failing to allow the deduction of the taxes of \$221,610.87 paid by petitioner in fiscal 1944, and that the amount of petitioner's net operating loss for that year, available as a carry-back to fiscal 1942 under the provisions of section 122(b) (1), should be re-computed to reflect such deduction. In his answer to petitioner's "Supplement and Amendment to Petition," respondent admitted:

\* \* \* a determination of a disallowance of a deduction claimed by the petitioner for the taxable year 1944 in the amount of \$221,610.87 for alleged taxes or interest paid, and that as a result of such disallowance the respondent has found and determined that petitioner had no net loss carry-back from 1944 to the taxable year 1942; \* \* \*.

As no factor of computation other than treatment of the \$221,610.87 taxes paid was put in issue, the effect of this decision is limited to a deduction of those taxes in arriving at the amount of net oper-

ating loss for fiscal 1944 and the carry-back available as a deduction for fiscal 1942.

Reviewed by the Court.

Decision will be entered under Rule 50.

Served Dec. 15, 1949.

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[Title of Tax Court and Cause.]

### RESPONDENT'S COMPUTATION FOR ENTRY OF DECISION

The attached proposed computation is submitted, on behalf of the respondent, to the Tax Court of the United States, in compliance with its opinion determining the issues in this proceeding.

This computation is submitted in accordance with the opinion of the Court, without prejudice to the respondent's right to contest the correctness of the decision entered herein by the Court, pursuant to the statutes in such cases made and provided.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of  
Internal Revenue.

/s/ CHARLES OLIPHANT,    ECC.  
Of Counsel:

B. H. NEBLETT,  
Division Counsel.

E. C. CROUTER,  
Special Attorney, Bureau of  
Internal Revenue.

C-TS:PD  
LA:KD

Recomputation Statement  
In re: Birch Ranch and Oil Company  
427 West Fifth Street  
Los Angeles 13, California

Jan. 18, 1950.

Docket No. 8720

Tax Liability

Year Ended	Liability	Assessed Income Tax	Deficiency
9/30/41	\$7,833.44	None	\$7,833.44
9/30/42	None	None	None
	<u>\$7,833.44</u>	<u>None</u>	<u>\$7,833.44</u>
Declared Value Excess Profits Tax			
9/30/41	\$4,565.41	None	\$4,565.41
9/30/42	None	None	None
	<u>\$4,565.41</u>	<u>None</u>	<u>\$4,565.41</u>

The attached schedules of tax computation were prepared under Rule 50 pursuant to the opinion of the Tax Court, promulgated December 15, 1949.

Birch Ranch and Oil Company      Recomputation Statement  
Taxable Year Ended Sept. 30, 1941

Schedule 1

Net income shown in the statutory notice of deficiency dated April 30, 1945 .....			\$34,711.24
Revised in accordance with the Tax Court's opinion (unchanged) .....			34,711.24
		Declared Value Excess	
	Income Tax	Profits Tax	
Tax liability (unchanged) .....	\$7,833.44	\$4,565.41	
Tax assessed .....	None	None	
Deficiency .....	\$7,833.44*	\$4,565.41*	

\* Note: These taxes were paid 7-7-47 to the Collector of Internal Revenue, who is holding as a deposit in a 9-D suspense account.

Taxable Year Ended Sept. 30, 1942

Schedule 2

Adjustments to Net Income

Net income shown in the statutory notice of deficiency dated April 30, 1945 .....		\$ 37,781.08
Revised (net loss) .....		(64,769.60)
Difference (decrease) .....		<u>\$102,550.68</u>

## Schedule 3

## Explanation of Adjustment

Net operating loss deduction is allowed as the result of a carry-back from the taxable year ended September 30, 1944. For computation see Exhibit A, herewith.

## Schedule 4

## Computation of Tax

	Income Tax	Declared Value Excess Profits Tax
Revised net income (loss), schedule 1..	(\$64,769.60)	(\$64,769.60)
Tax liability .....	None	None
Tax assessed .....	None	None
Deficiency .....	None	None

## Exhibit A

## Computation of Net Operating Loss Deduction

Taxable Year Ended Sept. 30, 1946

Net income shown in the revenue agent's report (re-examination) dated 11-7-47 .....	None
Add: Operating loss deduction (1946 carry-back) reversed .....	\$ 34,711.50
Contributions limited under section 23(q) .....	1,010.00
Total .....	\$ 35,721.50
Less: Taxes held allowable in the Tax Court's opinion .....	221,610.87
Net loss carry-back .....	\$185,889.37
Less:	
Adjustment—Section 122 Internal Revenue Code:	
Section 122(b), percentage depletion year 1944 .....	\$42,372.60
Section 122(c):	
Percentage depletion 1942 .....	35,806.09
Interest on U.S. obligations .....	5,160.00
	83,338.69
Net operating loss deduction .....	\$102,550.68

Received and Filed T.C.U.S. January 24, 1950.

The Tax Court of the United States  
Washington

Docket No. 8720

BIRCH RANCH & OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

This proceeding was called from the hearing calendar of March 1, 1950, for settlement pursuant to Rule 50. No appearance was made on behalf of the petitioner, and upon consideration of the respondent's computation filed on January 24, 1950, it is

Ordered and Decided: That there are deficiencies for the fiscal year ended September 30, 1941, in income tax and declared value excess-profits tax in the respective amounts of \$7,833.44 and \$4,565.41; and further, that there are no deficiencies in income tax and declared value excess-profits tax for the fiscal year ended September 30, 1942.

/s/ LUTHER A. JOHNSON,  
Judge.

Entered Mar. 3, 1950.

Served Mar. 6, 1950.



In the United States Court of Appeals  
for the Ninth Circuit

T. C. Docket No. 8720

COMMISSIONER OF INTERNAL REVENUE,

Petitioner on Review,

vs.

BIRCH RANCH AND OIL COMPANY,

Respondent on Review.

PETITION FOR REVIEW AND  
STATEMENT OF POINTS

To the Honorable Judges of the United States  
Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue petitions The United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on March 3, 1950, pursuant to its Findings of Fact and Opinion promulgated December 15, 1949, ordering and deciding "that there are deficiencies for the fiscal year ended September 30, 1941, in income tax and declared value excess-profits tax in the respective amounts of \$7,833.44 and \$4,565.41; and further, that there are no deficiencies in income tax and declared value excess-profits tax for the fiscal year ended September 30, 1942." This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the United States Internal Revenue Code as amended.

## I.

## Jurisdiction

Birch Ranch and Oil Company, respondent on review herein, is a corporation organized under the laws of the State of Nevada on or about October 15, 1934, with its place of business at Los Angeles, California, and filed its Federal income and declared value excess-profits tax return for the fiscal year ended September 30, 1942, herein involved, with the Collector of Internal Revenue for the Sixth District of California located at Los Angeles, California, which collection district is within the jurisdiction of The United States Court of Appeals for the Ninth Circuit, wherein review is sought. This case involves Federal income and declared value excess-profits taxes for the fiscal year ended September 30, 1942.

## II.

## Nature of Controversy

The question to be presented to the reviewing court is: Is taxpayer entitled to a deduction in the taxable year 1944, resulting in a net operating loss carry-back to 1942 under Section 122(b)(1) of the Code, on account of payments made on call for so-called "interest or taxes" in the aggregate amount of \$221,610.87, including delinquency penalties, assessed on behalf of a California Reclamation District upon improvements to lands comprising such district all of which land was practically owned and operated by taxpayer, with which to pay the tax-exempt interest on the district's bonds, substantially

all of which were owned or controlled by taxpayer's sole stockholders?

The taxpayer-corporation, whose sole stockholders were A. Otis Birch and wife and whose books were kept on a cash basis, owned substantially all the land comprised in a California reclamation district, known as "Conaway Ranch," upon which its predecessor-partnership, the Birch Oil Company, owned by the "Birch family group" constructed and made drainage improvements at a cost of \$2,000,000. at the instigation and direction of the reclamation state board for which it received a warrant in payment. Thereafter \$2,000,000. of 6% district bonds were sold to Birch for which the warrant was given in payment and part of the bonds were distributed or sold to others. However, by the middle of 1944 Mr. and Mrs. Birch had acquired all of the bonds except 10 which were owned by Mr. Birch's cousin. The principal and interest were payable out of moneys collected by the county from assessments against benefited land and although the last of the bonds were to mature on January 1, 1943, no amount was ever paid into the district by the Birchs or the taxpayer for the purpose of paying them off. For all practical purposes the taxpayer and the district were one and the same. Calls for the so-called "taxes" were made at the taxpayer's and Birch's convenience and during the taxable year 1944 calls aggregating the sum of \$221,610.87, including delinquency penalties, were made for assessments against the "Conaway Ranch" for which to pay interest due and past due for prior years.

The aforementioned payments were deducted in 1944 as "taxes paid" and were disallowed by the Commissioner. Their allowance results in a "net carry-back loss" for the taxable year 1944 in the amount of \$185,889.37 and an adjusted net operating loss deduction of \$102,550.68 carry-back to 1942 (Section 122(b) of Internal Revenue Code), which eliminates the entire net income as adjusted for 1942 in the amount of \$37,781.08 and the proposed deficiencies in income and declared value excess profits taxes in the respective amounts of \$11,915.67 and \$1,687.10, exclusive of interest due thereon.

The Commissioner contended before the Tax Court that the claimed deduction for "interest or taxes" paid during 1944 were properly disallowed and accordingly there is no net operating loss carry-back to the year 1942, because (1) the reclamation district was a fiction, indistinguishable from the taxpayer-corporation and its stockholders; (2) the corporate identity of the taxpayer should be disregarded as far as any alleged liability to its stockholders are concerned; (3) there was a merger of all liens and estates and any liability for interest or taxes was extinguished and (4) the payments of "interest" on reclamation bonds during the taxable year constituted payments of indebtedness incurred and continued to purchase or carry obligations, the interest upon which is wholly exempt from Federal tax, which is not deductible under Section 23(b) of the Code; and further the payments were not ordinary and necessary expenses incurred or paid in



1944 in operating the ranch in such year but to pay interest to its stockholders on tax-exempt bonds.

In holding adversely to the Commissioner the Tax Court found that "as all of the \$221,610.87 paid to the county treasurer was for application to interest charges, none of it is excluded as a deduction by the statutory exceptions "under Section 23(c)(1)(E) of the Code. It also concluded that, although it may ignore the negligible 240 district acres which taxpayers did not own and against which no calls apparently were made, it could not ignore a "public district" invested with taxing powers and other sovereign attributes and the substance attaching to the number of bonds which were held by parties who had no identity of economic interest with the Birchs in respect to which deductions had been allowed and approved in prior year proceedings of this taxpayer (T.C. Docket No. 109993—3 T.C.M. 378—1944, *aff'd* CA-9, 1946, 152 F. (2) 874, *c.d.* 328 U.S. 863). Thus recognizing the districts as a legal entity, it viewed the taxpayer's "payments as made in satisfaction of taxes, and not of interest on indebtedness incurred and continued to purchase and carry tax-exempt obligations," and "as taxes assessed for interest only, they are not of a kind tending to increase the value of the property assessed, and hence are properly deductible."

The Commissioner presents that the record supports his position that since the taxpayer owned all the land of the district upon which calls were made and it or its stockholders owned substantially all the bonds of the district, the taxpayer's obligation to



pay "taxes" and the district's obligation to pay "interest" on the bonds was lacking in substance. Also that the district was in fact, if not in form, a private district; that in actual operation it was treated as a private district because no assessment taxes were paid from 1937 to 1943, no sinking fund was created, and the fiction of a public district was artificially kept alive to the end that taxpayer might deduct the amount which it paid as taxes, which amount it or its two stockholders received back as tax-exempt interest. The parties stipulated that the taxpayer and the district were one and the same for all practical operating purposes but the Tax Court apparently gave little weight to this part of the stipulation.

Even if there was a bona fide district originally organized, the agreed facts show that Mr. Birch and his wife acquired complete ownership and control of the district and ranch by 1944, except for 10 bonds, which were owned by Mr. Birch's cousin. The other bonds owned in prior years and the early part of 1944 were either owned by members of the "Birch family group"—cousins and nieces—and by a corporation of which Birch was president and a director. Mr. Birch and his wife merely used this device to siphon off large ranching profits from 21,000 acres in the guise of payment of "taxes" to the county treasurer, who would then repay similar amounts to Birch and his wife as tax-exempt interest. These payments were made largely to suit the convenience of the Birch's and the taxpayer, which kept its books and filed its returns on a cash basis.

The bonds began to mature on January 1, 1935, and were to be retired by January 1, 1943, and as of the time of the hearing herein on June 30, 1947, no amount had been ever assessed by or paid to the county or the district by either the Birchs or the taxpayer for the purpose of paying off the bonds. The resulting effect of the arrangement in 1944 and thereafter, as sustained by the decision of the Tax Court, establishes a continuing tax-avoidance loophole whereby taxpayers deduct payments for so-called taxes when it decides to call for them to pay its shareholders tax-exempt interest at six per cent on the bonds. Such a resulting tax avoidance scheme is contrary to the principles of *Higgins v. Smith* (1940) 308 U.S. 473 and *Gregory v. Helvering* (1935) 293 U.S. 465.

If such payments are deductible, then it is further presented that, in the alternate, in allowing a deduction for "penalties" as part of the aggregate payment made of \$221,610.87—contrary to *Helen B. Achelis* (1933) 28 B.T.A. 244, 246 and cases cited and *Edward G. Acheson Jr.*, T.C. Memo. Op. (1943) 1 T.C.M. 877—the Tax Court also erred.

### III.

#### Statement of Points

That the Commissioner of Internal Revenue, being aggrieved by the opinion and decision of The Tax Court of the United States in this proceeding, hereby petitions for a review of said opinion and decision by The United States Court of Appeals for the Ninth Circuit, and for the correction of the

manifest errors which therein occurred and intervened to his prejudice. The Commissioner submits the following statement of points upon which he intends to rely as the basis of this petition for review:

That the Tax Court of the United States erred:

1. In holding and deciding that under the circumstances involved herein, the amounts paid on call of the county treasurer as "taxes" to meet interest on bonds of a California reclamation district are deductible in the taxable year 1944 under Section 23 of the Internal Revenue Code.

2. In failing to hold and decide that under the circumstances involved herein, the amounts paid on call of the county treasurer as "taxes" to meet interest on bonds of a California reclamation district are not deductible in the taxable year 1944 under Section 23 of the Internal Revenue Code.

3. In holding and deciding that the taxpayer is entitled to a deduction for "taxes to meet interest" in the taxable year 1944 in the amount of \$221,610.87.

4. In failing to hold and decide that taxpayer is not entitled to any deduction for "taxes to meet interest" in the taxable year 1944.

5. In holding and deciding that taxpayer's assessment payments used to pay interest on the bonds in the taxable year 1944 are deductible under and because of its prior decision covering the years 1937 and 1939 of this taxpayer in Docket No. 109993—

(3 T.C.M. 378—1944, aff'd CA-9, 1946, 152 F. (2) 874, c.d. 328 U.S. 863).

6. In holding and concluding that all of the \$221,610.87 paid to the county treasurer was "for application to interest charges" and accordingly none of it is excluded as a deduction by the statutory exceptions under the provisions of subparagraph E of Section 23(c) of the Internal Revenue Code.

7. In holding and finding that the payments of \$221,610.87 were made in satisfaction of "taxes" and not "interest" and were not of a kind tending to increase the value of the property assessed within the meaning of Subsection (a) of Section 23(c)(1) of the Internal Revenue Code.

8. In failing to hold and decide that the "payments of interest on reclamation bonds" were the payment of interest on indebtedness incurred and continued to purchase and carry tax-exempt obligations and hence not deductible under Section 23(b) of the Internal Revenue Code.

9. In failing to hold and find that the tax and interest payments had no business purpose and did not discharge any real legal obligation.

10. In holding and deciding that the Reclamation District No. 2035 was a "public district" and operated as such.

11. In failing to hold and find that taxpayer's obligation to pay taxes and the district's obligation



to pay interest on the bonds, under the circumstances, was lacking in substance.

12. In holding and deciding that since the Reclamation District was a "public district" or legal entity it could not be disregarded under the circumstances involved herein.

13. In failing to hold and find that the Reclamation District No. 2035 was in fact, if not in form, a private district and operated as such.

14. In failing to hold and find that the Reclamation District No. 2035 was in reality a mere fiction indistinguishable from the taxpayer and its sole stockholders.

15. In holding and finding that a very large number of bonds were held by parties who had no identity of economic interest with Mr. and Mrs. Birch.

16. In failing to hold and find that the Birchs, the taxpayer and the reclamation district were all one and the same in substance.

17. In failing to hold and find that when Mr. Birch and his wife re-acquired the bonds all prior lien and taxes were merged and extinguished.

18. In holding and deciding that taxpayer is entitled to a net operating loss carry-back deduction for the taxable year 1944 available for the taxable year 1942 in the amount of \$102,550.68 under Section 122(b) of the Internal Revenue Code.

19. In failing to hold and decide that there was



no net loss carry-back for the taxable year 1944 available as a deduction for the taxable year 1942 under Section 122(b) of the Internal Revenue Code.

20. In failing to hold and decide that taxpayer realized a net taxable income in the amount of \$35,-721.50 for the taxable year 1944.

21. In failing to hold and decide, in the alternate, that the 10 per cent added to the assessment for taxes and paid on account of delay in payment of such taxes, is a penalty and nondeductible for Federal income tax purposes.

22. In failing to hold and decide, in the alternate, that such portion of the aggregate payment of \$221,610.87 that constitute "delinquent penalties" are not deductible as taxes.

23. In that its opinion and decision are contrary to the law and the regulations and is not supported by substantial evidence of record.

24. In ordering and deciding that there are no deficiencies in income tax and declared value excess profits tax for the fiscal year ended September 30, 1942.

25. In failing to order and decide that there are deficiencies in income tax and declared value excess profits tax for the fiscal year ended September 30, 1942, in the respective amounts of \$11,915.67 and \$1,687.10.

Wherefore, the Commissioner petitions that said findings of fact and opinion and decision of The

Tax Court of the United States be reviewed by The United States Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with the law and the rules of said Court and be transmitted to the Clerk of the said Court for filing; and that appropriate action be taken to the end that the errors herein complained of may be reviewed and corrected by said Court.

/s/ THERON L. CAUDLE, CAR  
Assistant Attorney General.

/s/ CHARLES OLIPHANT, CAR  
Chief Counsel Bureau of Internal Revenue  
Counsel for Petitioner on Review.

Of Counsel:

CLAUDE R. MARSHALL,  
Special Attorney  
Bureau of Internal Revenue.

Received and Filed T.C.U.S. May 19, 1950.

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[Title of Court of Appeals and Cause.]

NOTICE OF FILING PETITION  
FOR REVIEW

To: George Acret, Esq.,  
650 South Grand Avenue  
Los Angeles 14, California

You are hereby notified that the Commissioner of Internal Revenue did, on the 19th day of May, 1950,

file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 19th day of May, 1950.

/s/ CHARLES OLIPHANT, CAR  
Chief Counsel, Bureau of Internal Revenue  
Counsel for Petitioner on Review.

Service acknowledged.

Received and Filed T.C.U.S. May 31, 1950.

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[Title of Court of Appeals and Cause.]

NOTICE OF FILING PETITION  
FOR REVIEW

To: R. R. Landrum, Secretary  
Birch Ranch & Oil Company  
427 West Fifth Street  
Los Angeles, California

You are hereby notified that the Commissioner of Internal Revenue did, on the 19th day of May, 1950, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A

copy of the petition for review as filed is hereto attached and served upon you.

Dated this 19th day of May, 1950.

/s/ CHARLES OLIPHANT, CAR  
Chief Counsel, Bureau of Internal Revenue  
Counsel for Petitioner on Review.

Service acknowledged.

Received and Filed T.C.U.S. May 31, 1950.

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[Title of Court of Appeals and Cause.]

### MOTION

Now Comes the Commissioner of Internal Revenue, petitioner on review in the above-entitled cause, by and through his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and moves that the time within which to prepare, transmit and deliver the record on review in this cause in The United States Court of Appeals for the Ninth Circuit be extended to and including August 17, 1950, and for cause shows:

That a petition to have the Tax Court's decision herein reviewed by the Court of Appeals for the Ninth Circuit was filed on May 19, 1950; that the time for filing the record on review now expires on June 28, 1950; that the matter of the disposition of this cause is still under consideration by the Government and that the determination of such further action will be made within the next 45 days; that

the preparation and transmittal of the transcript of record on review under the above circumstances would require unnecessary expenses to the parties herein; and that in any event the record herein cannot be completed and filed within the time now allowed.

Wherefore, it is prayed that this motion be granted.

/s/ CHARLES OLIPHANT,  
Chief Counsel,  
Bureau of Internal Revenue.

Of Counsel:

CLAUDE R. MARSHALL,  
Special Attorney,  
Bureau of Internal Revenue.

Received and Filed T.C.U.S. June 19, 1950.

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The Tax Court of the United States  
Washington

Docket No. 8720

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

vs.

BIRCH RANCH & OIL COMPANY,  
Respondent.

ORDER ENLARGING TIME

Upon motion of counsel for petitioner, it is  
Ordered that the time for preparation, transmis-



sion and delivery of the record sur petition for review of the above-entitled proceeding in the United States Court of Appeals for the Ninth Circuit is extended to August 17, 1950.

[Seal]      /s/ J. E. MURDOCK,  
Acting Presiding Judge.

Dated: Washington, D. C., June 19, 1950.

Served June 21, 1950.

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In the United States Court of Appeals  
for the Ninth Circuit

T. C. Docket No. 8720

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner on Review,

vs.

BIRCH RANCH AND OIL COMPANY,  
Respondent on Review.

### NOTICE OF RECORD ON REVIEW

To the Clerk of The Tax Court of the  
United States:

Pursuant to the provisions of rule 11 of the amended rules of The United States Court of Appeals for the Ninth Circuit, you are hereby notified that the petitioner on review will not exclude or omit any of the original papers made a part of the

record in this proceeding before The Tax Court of the United States.

/s/ THERON L. CAUDLE,  
Assistant Attorney General.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of Internal Revenue  
Counsel for Commissioner of Internal Revenue.

Consented to:

/s/ GEORGE ACRET,

Received and Filed July 6, 1950.

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The Tax Court of the United States  
Washington

[Title of Cause.]

### CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States do hereby certify that the foregoing documents, 1 to 52, inclusive, constitute and are all of the papers and proceedings on file in my office as the original and complete record in the proceeding before The Tax Court of the United States entitled: "Birch Ranch and Oil Company, Petitioner, v. Commissioner of Internal Revenue, Respondent," Docket No. 8720 and in which the respondent in the Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said

Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 1st day of August, 1950.

[Seal]        /s/ VICTOR S. MERSCH,  
                 Clerk.

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[Endorsed]: No. 12639. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Birch Ranch and Oil Company, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed August 7, 1950.

              /s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for the  
Ninth Circuit.

In the United States Court of Appeals  
for the Ninth Circuit

No. 12,639

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

vs.

BIRCH RANCH & OIL CO.,

Respondent.

PETITIONER'S DESIGNATION OF CON-  
TENTS OF PRINTED RECORD ON REVIEW

The petitioner, by and through his undersigned attorney, pursuant to the provisions of Rule 19(6) of this Court, hereby designates the entire record of the proceedings in the above-styled cause to be printed on review, with the exception of Petitioner's Exhibits 1 through 12, inclusive, 14 and 15, Respondent's Exhibits B through E, inclusive, and Joint Exhibits 3a and 13f, which counsel for the respective parties hereto have stipulated may be physically transmitted to the Court.

Dated this 15th day of August, 1950.

/s/ THERON LAMAR CAUDLE,  
Assistant Attorney General,  
Counsel for the Petitioner.

Receipt of the above and foregoing Petitioner's Designation of Contents of Printed Record on Review is acknowledged this 18th day of August, 1950.

/s/ GEORGE ACRET,  
Counsel for the Respondent.

[Endorsed]: Filed August 21, 1950.

[Title of Court of Appeals and Cause.]

STIPULATION AND ORDER

It is hereby stipulated by and between counsel for the respective parties hereto, subject to the approval of the Court, that Petitioner's Exhibits 1 through 12, inclusive, 14 and 15, Respondent's Exhibits B through E, inclusive, and Joint Exhibits 3a and 13f shall not be required to be printed as part of the record herein, but may be physically transmitted to the Court; counsel for both parties reserving the right to refer to the aforementioned exhibits on brief or in argument in all respects as if they constituted part of the printed record, however.

Dated this 15th day of August, 1950.

/s/ THERON LAMAR CAUDLE,  
Assistant Attorney General,  
Counsel for Petitioner.

/s/ GEORGE ACRET,  
Counsel for Respondent.

So Ordered:

/s/ WILLIAM DENMAN,  
Chief Judge.

/s/ CLIFTON MATHEWS,

/s/ WM. E. ORR,  
United States Circuit Judges.

[Endorsed]: Filed August 22, 1950.



